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Parallel importation refers to importing intellectual property goods into a market and sold without authorization of the intellectual property owners in that market. It is an international trade phenomenon, and it is also a significant international trade issue related to intellectual property rights. It has close relations with the intellectual property exhaustion doctrine. In trademark law, most of the world's large economies have clear exhaustion doctrine. Surprisingly, however, China does not have clear law and policy on parallel importation — despite being the world's second-largest economy and a nation known worldwide for being central to the international trade system. The parallel importation disputes are increasingly common in Chinese courts, especially after the establishment of the Free Trade Zones. What's more, in practice, Chinese courts allow and hold in favor of parallel importation. Apart from the rising trade in trademarked goods, the Chinese government takes note of a vast and growing practice of Chinese tourists financing their trips abroad by reselling the goods they bring back in their suitcases — the "daigou" phenomenon. This daigou phenomenon raises both parallel importation and tax issues because these tourists are arguably smuggling goods without paying tariffs. All of these activities reflect or promote intellectual property trade development and make it impossible for China to neglect this issue any longer. This Article explains why parallel importation laws are necessary and outlines the crucial features of such a law to guide legislators who could react to it.

I. INTRODUCTION

Intellectual property plays an essential role in the global trade integration process. Parallel importation is an international trade phenomenon, and it is also a significant international trade issue related to intellectual property rights. "Parallel importation" refers to the importation of intellectual property goods into a market and sold without the authorization of the intellectual property owners in that market. Whether a country permits the parallel importation or not depends on which type of exhaustion doctrine it adopts.

The "exhaustion doctrine" is one of the limits on intellectual property rights. It means once a product protected by intellectual property rights has been launched on the market with the intellectual property owners' consent, the intellectual property owners cannot control the further distribution or resale of the given product.[1] Thus, if X sells an intellectual property protected product to Y, the exhaustion doctrine lets Y distribute the product further without X's permission. Despite its importance, there is no international consensus on a uniform exhaustion doctrine. Article 6 of The Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) leaves the details of the exhaustion doctrine for signatory members to determine.[2] Different nations adopt different exhaustion regimes, and thus have different stances on parallel importation.

Most of the world's large economies have clear exhaustion doctrine: the EU adopts the regional exhaustion approach, and the U.S. takes the international exhaustion approach. Surprisingly,

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[1] *See Interface Between Exhaustion of Intellectual Property Rights and Competition Law*, COMM. ON DEV. AND INTELLECTUAL PROP. (CDIP), World Intellectual Property Organization, Annex, Page 3, Eighth Session (Nov. 14-18, 2011). This document was prepared as an integral component of the Thematic Project on Intellectual Property and Competition Policy, as revised and approved at the fourth session of the CDIP, held in Geneva, on Nov. 16-20, 2009, https://www.wipo.int/edocs/mdocs/mdocs/en/cdip_8/cdip_8_inf_5_rev.pdf (last visited Jun. 16, 2020).

[2] Agreement on Trade-Related Aspects of Intellectual Property Rights, Apr. 15, 1994 [hereinafter TRIPS]; TRIPS Agreement, Art. 6.

however, China does not have clear law and policy on parallel importation—despite being the world's second-largest economy and a nation known worldwide for being central to the international trade system.

One reason for this silence is that China didn't need an answer. Parallel importation usually happens *into* prosperous countries *from* less developed countries because importers depend on price differences to survive. Until recently, China was plainly in the latter category. However, in China, as a fast-growing economic entity, the international intellectual property imports have proliferated in recent years based on the 2019 World Intellectual Property Report.[3] International intellectual property trade is essential to China. Since 2013, China established several China Pilot Free Trade Zones to explore new paths and models for China's opening to the outside world, as well as promote the transformation of economic growth patterns and optimize economic structures.[4] Further, China strengthened the construction of its intellectual property protection environment, amended intellectual property laws, and increased law enforcement. And, as anyone who has visited a high-end fashion retailer in America or Europe can attest, Chinese visitors are avid buyers of trademarked goods (which they often resell back home to the consternation of the intellectual property owners). All of these activities reflect or promote intellectual property trade development and make it impossible for China to neglect this issue any longer at the same time.

What's more, parallel importation disputes are increasingly common in Chinese courts, especially in the trademark area. Since the first reported case involving trademark parallel importation in

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[3] *See The Geography of Innovation: Local Hotspots, Global Networks*, WORLD INTELLECTUAL PROPERTY ORGANIZATION, World Intellectual Property Report 2019, at 8, https://www.wipo.int/edocs/pubdocs/en/wipo_pub_944_2019.pdf (last visited Aug. 2, 2020).

[4] *See* The World Bank in China, WORLD BANK, 2020, https://www.worldbank.org/en/country/china/overview.

1999,[5] more and more international trademark owners filed lawsuits in China concerning the trademark exhaustion and parallel importation issue, especially after the establishment of the Free Trade Zones. Yet these disputes do nothing to establish the law because China is a civil law country, and most cases decided by courts in China do not have precedential value.[6] Trademark owners, consumers, and the courts need an explicit statute to deal with the trademark parallel importation issue.

Although China previously clarified its law on a related form of parallel importation (patented goods),[7] reform efforts petered out before a resolution could be found for trademark law. That being said, there is reason to believe a clarifying statute will finally be enacted in the near future. Apart from the rising trade of trademarked goods, Chinese officials have taken note of the vast and growing practice of Chinese tourists financing their trips abroad by reselling the goods they bring back in their suitcases. This *daigou* phenomenon raises both parallel importation issues and tax issues because these tourists are arguably smuggling goods without paying tariffs. *Daigou* thrives in part because of an absence of clear trademark exhaustion statutes and no specific parallel importation policy. The solution is for China to answer the legal questions and define the trademark exhaustion doctrine through legislation. This Article explains why new laws are necessary and outlines the crucial features of such laws to guide legislators who could enact it.

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[5] *See* Wu Jianchuang, *Viewing the Legal Issues of Parallel Imports from the Shanghai Lihua Trademark Case*, LAW STAR (Oct. 8, 2007), http://service.law-star.com/cacnew/200710/50008774.htm.

[6] The exceptions are cases adjudicated by the Supreme People's Court, but there are no such cases on this topic.

[7] *See* Order of the President of the People's Republic of China No.8 (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 27, 2008, effective Oct. 1, 2009), art. 69, "[t]he following shall not be deemed to be patent right infringement: (1) After a patented product or a product directly obtained by using the patented method is sold by the patentee or sold by any unit or individual with the permission of the patentee, any other person uses, offers to sell, sells or imports that product…" at 13-14, https://www.wipo.int/edocs/lexdocs/laws/en/cn/cn028en.pdf.

This Article proceeds as follows: Section II introduced the trademark exhaustion doctrine and parallel importation; Section III elaborates on the current trademark exhaustion approach in China. This section is divided into three parts to show the "practice beforehand"—how the courts reach to the current international trademark exhaustion doctrine in practice; Section IV presents how trademark exhaustion works in other countries, using the United States and the European Union (EU) as examples; Section V discusses the parallel importation variation in China, referred to as *daigou* fever, to show why China needs to change their laws immediately. Section VI discusses two problems with the current parallel importation regime and explains how to clarify the law in a future trademark exhaustion statute. Section VII concludes the Article.

II. TRADEMARK EXHAUSTION DOCTRINE AND PARALLEL IMPORTATION

A. STYLIZED FACTS ON TRADEMARK EXHAUSTION DOCTRINE

Trademark exhaustion, which can also be referred to as the trademark first sale rule, states the right of a trademark owner "to control the distribution of its trademarked product does not extend beyond the first sale of the product."[8] Additionally, "[r]esale by the first purchaser of the original article under the producer's trademark is neither trademark infringement nor unfair competition."[9]

Trademarks have different functions compared to copyrights and patents. Trademarks possess the ability to indicate the source of goods. Trademarks grant trademark owners the ability to prevent third parties from using similar or identical marks on similar or

[8] Sebastian Int'l, Inc. v. Longs Drug Stores Corp., 53 F.3d 1073, 1074 (9th Cir. 1995); David W. Barnes, *Free-Riders and Trademark Law's First Sale Rule*, 27 SANTA CLARA HIGH TECH. L.J. 457, 461 (2011), https://digitalcommons.law.scu.edu/cgi/viewcontent.cgi?article=1522&context=chtlj.

[9] Sebastian Int'l, Inc., 53 F.3d at 1073, 1074.

identical products to avoid consumer confusion.[10] Trademarks also represent and guarantee the quality of products.[11] The exhaustion doctrine helps to determine the boundaries of the extent to which trademark owners can "constrain the behavior of other people to use things in their rightful possession."[12] The principle of trademark exhaustion 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."[13]

Cross-border transactions have become increasingly prevalent in the wake of economic globalization and trade integration. The trade of intellectual property products is an essential and indispensable part of it.[14] TRIPS plays an essential role in establishing the international law of intellectual property rights. However, there is a blank space in the TRIPS Agreement which pertain to the exhaustion doctrine. Article 6 of TRIPS provides that "nothing in the Agreement shall be used to address the issue of the

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[10] *See* 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); Irene Calboli, *Market Integration and (The Limits Of) The First Sale Rule in North American and European Trademark Law*, 51 SANTA CLARA L. REV. 1241, 1248-49 (2011).

[11] *See id.*

[12] Molly Shaffer Van Houweling, *Exhaustion and The Limits of Remote-Control Property*, 93 DENV. L. REV. 951 (2016); *See* Molly Shaffer Van Houweling, *Exhaustion and Personal Property Servitudes, in* RESEARCH HANDBOOK ON INTELLECTUAL PROPERTY EXHAUSTION AND PARALLEL IMPORTS (Irene Calboli & Edward Lee ed., 2016).

[13] Calboli, *supra* note 10, at 1250; Shubha Ghosh & Irene Calboli, *Trademark Exhaustion Across Selected Jurisdictions*, EXHAUSTING INTELLECTUAL PROPERTY RIGHTS: A COMPARATIVE LAW AND POLICY ANALYSIS 66 (Cambridge University Press, 2018).

[14] *Agreement on Trade-Related Aspects of Intellectual Property Rights*, April 15, 1994; *Marrakesh Agreement Establishing the World Trade Organization*, Annex 1C, 1869 U.N.T.S. 299 [hereinafter TRIPS Agreement]. TRIPS was negotiated at the end of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) in 1994 and is administered by the WTO.

exhaustion of intellectual property rights."[15] TRIPS does not imply, prescribe, or prohibit a regime of exhaustion and leaves the autonomous right to all the World Trade Organization (WTO) member nations.

There are three versions of exhaustion doctrine based on the geographical scope: national exhaustion, international exhaustion, and regional exhaustion. According to national exhaustion, intellectual property rights to a particular good are exhausted only if the good is manufactured or sold within the country's domestic market. The acceptance of the principle of the exhaustion doctrine has rarely been questioned for the unauthorized sale of genuine goods originating within national markets.[16] This is because courts and trademark theorists reached a consensus on the rights of a trademarked products' proprietor, agreeing that proprietors "should remain free to enjoy the specific privileges of traditional ownership," and more specifically "should be free to resell or otherwise dispose of his property."[17]

At the other extreme, international exhaustion doctrine does not care about the manufacturing and first distribution location. It allows all authorized goods to be freely resold in the country's domestic market. A nation that endorses international exhaustion has mainly opted for worldwide exhaustion concerning the item sold. The U.S. adopted the international exhaustion doctrine in trademark law a long time ago, and China also reaches to consensus

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[15] TRIPS Agreement, art. 6.

[16] Calboli, *supra* note 10, at 1252.

[17] *See id*.; *see* Herman Cohen Jehoram, *International Exhaustion versus Importation Right: A Murky Area of Intellectual Property Law*, 4 G. R. U. R. INT'L 280 (1996). Trademark owners want to use trademark exclusive rights to control the downstream market, and trademark exhaustion defeats this market division strategy. However, trademark owners can still impose restrictions on further distribution through contract system. They can't enforce those restrictions through trademark law, however, the contract law, even the antitrust law still works if there are anti-competitive terms and conditions in contracts. This article will not discuss further in detail about how contract and antitrust laws work.

through legal practices and takes international exhaustion in the trademark area.

In between these two extremes, regional exhaustion applies to goods initially put on a specific group of countries' markets. Usually, this specific group of countries is a treaty-based trading group, like the European Union (EU). Within the EU or European Economic Community (EEC) scope, there is no reason to prevent the free circulation of genuine goods across the Member States after the first sale within this region. The principle behind regional exhaustion is the integration of the internal market and the free movement of products across the EU and the EEC. Which type of exhaustion regime that each country applies will significantly impact intellectual property rights owners.

B. PARALLEL IMPORTATION

1. Definition

Parallel importation, also known as gray market goods, are genuine goods purchased in one country and then brought into a second country for resale without the intellectual property rights owners' authorization.[18] Parallel imports have a close relation to the exhaustion doctrine. Whether such trade is legally permitted depends on which type of exhaustion doctrine a country chooses. When a state chooses the national exhaustion doctrine, parallel importation is prohibited. When a state chooses the international exhaustion doctrine, it permits parallel importation. Hence, intellectual property rights are exhausted upon the first sale anywhere outside the domestic market, and parallel importation can occur despite opposition from intellectual property owners. The regional exhaustion doctrine permits parallel importation within a

[18] *See* Quality King Distributors, Inc. v. L'anza Research Int'l., Inc., 523 U.S. 135, 153 (1998) (citing K Mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988), "parallel importation refers to the importation of foreign-manufactured goods bearing a valid United States trademark without the consent of the trademark holder."). *See also* Kirtsaeng v. John Wiley & Sons, Inc., 133 S.Ct. 1351 (2013), at 1379, n.9 ("[T]he term gray market good refers to a good that is imported outside the distribution channels that have been contractually negotiated by the intellectual property owner.").

specific geographic area. Regional exhaustion doctrine will be illustrated in Section IV with a discussion of EU trademark exhaustion.

As stated above, TRIPS gives full latitude to WTO member nations to choose their exhaustion regimes, so different countries implement different exhaustion regimes in each intellectual property field. Because there is no global consensus on the exhaustion doctrine, the type of regime each country chooses depends on the actual condition of each country.

The main reason that gave rise to parallel importation is price discrimination. Price discrimination is ubiquitous in the current market. Producers will likely charge a higher price where the demand is high or when consumers have a better ability to pay, or charge a lower price where the demand is low or when consumers cannot afford the product. For example, with global price discrimination, intellectual property owners can charge different prices in different countries' markets according to the supply-demand curve. It also gave intellectual property owners more power to control the price and the subsequent downstream distribution. National exhaustion doctrine allows intellectual property owners to implement global price discrimination without worrying about the low-priced products in other markets flooding and ruining the domestic market. It seems that price discrimination is a desirable tool for intellectual property owners to get further control over the distribution of goods. However, parallel importation is a form of arbitrage as to price discrimination, and it defeats many market segmentation schemes. Under international trade integration, many multinational companies set up the international commerce chain, primarily driven by intellectual property technology, making choices on parallel imports more controversial.

2. Price Discrimination

According to Carl Shapiro and Hal R. Varian, within the broader domain of price discrimination, there is a commonly

accepted classification dating to the 1920s.[19] There are three degrees of price discrimination. The first degree, also called personalized pricing, is sold to each user at a different price.[20] With the first degree price discrimination, the producers can charge the maximum possible price for each unit that allows producers to capture all the available consumer surplus for themselves; this is why it is also known as perfect price discrimination. Nevertheless, in practice, first-degree discrimination is very rare because each consumer's preference is private and very hard to identify accurately.[21] The second degree is called versioning, which is offering information products in different versions for different market segments.[22] Sellers will identify different dimensions of a product that some customers highly value while others assign little value; therefore, it constitutes a useful tool of self-selection to appeal to customers with different willingness to pay.[23] For example, booksellers offer hardcover books and paperback books, movie producers will first lease their productions in theaters and then move to online or digital video disk, and airlines have different classes of tickets. So, when sellers implement second degree price discrimination, high-value customers who desire a higher quality product, are impatient to wait for movies to launch online, or prefer more comfortable seats, will not mind paying a higher price to receive better products or services. The third degree of price discrimination, also known as group pricing, is when sellers will offer the same product to different groups of consumers for different prices.[24] For example, students and seniors will often get discounts when buying a movie ticket. While these three types are not mutually exclusive, sellers will use them together in building a

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[19] Carl Shapiro & Hal R. Varian, INFORMATION RULES: A STRATEGIC GUIDE TO THE NETWORK ECONOMY 39 (Harvard Business School Press) (1999).

[20] *Id.*

[21] *See* Guy A. Rub, *Contracting Around Copyright: The Uneasy Case for Unbundling of Rights in Creative Works*, 78 U. CHI. L. REV. 257, 262 (2011).

[22] *See* Shapiro & Varian, *supra* note 19, at 54.

[23] *Id*.

[24] *Id*. at 39.

product distribution line. So, implementing geographic price discrimination on intellectual property related products is associated with the second and third degree.

Price discrimination occurs when there is a variation in demand for a product across countries, and sellers set different prices in different countries to serve buyers with varying willingness to pay. In the parallel importation context, people who support the national exhaustion regime will often cite the benefits of implementing international price discrimination and argue that parallel imports should be prohibited. The main arguments in favor of geographic price discrimination are divided into two parts. The first aspect is that it increases both output and access.[25] Proponents of international price discrimination argue that parallel imports permit goods in lower-priced markets to flow back to the higher-priced market and force prices in the higher-priced market to go down. Suppliers will not allow the arbitrageurs to bear fruit over time, so they will either raise the price in lower-priced markets to a global uniform price or abandon those markets altogether to reduce the harm.[26] By imposing price discrimination schemes, people in lower-income areas will still get the chance to buy the products at a lower price; therefore, compared to the uniform price, geographic price discrimination increases the output and access of the good.

The second aspect is that the price discrimination scheme will increase the total surplus, reduce the deadweight loss, encourage investment in the research and development section,[27] and

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[25] *See* David A. Malueg & Marius Schwartz, *Parallel Imports, Demand Dispersion, and International Price Discrimination*, 37 J. Int'l Econ. 167 (1994).

[26] *See* Guy A. Rub, *The Economics of Kirtsaeng v. John Wiley & Sons, Inc.: The Efficiency of a Balanced Approach to the First Sale Doctrine*, 81 FORDHAM L. REV. RES GESTAE 41, 47 (2013); S. Zubin Gautam, *The Murky Waters of First Sale: Price Discrimination and Downstream Control in the Wake of Kirtsaeng v. John Wiley & Sons, Inc.*, 29 BERKELEY TECH. L. J. 717, 733 (2014); Malueg & Schwartz, *supra* note 25, at 190.

[27] *See* Ariel Katz, *The First Sale Doctrine and the Economics of Post-Sale Restraints*, 2014 B.Y.U. L. Rev. 55, 78 (2014).

contribute to dynamic efficiency.[28] The increased output may contribute to the total surplus increase. Compared to lower-income market abandonment, price discrimination increases access to the secondary market and reduces social deadweight loss.[29] Moreover, regarding the research and development section, there is an argument against legalizing parallel trade that parallel imports will reduce the profits that the manufacturer earned, leading the investment to the product decreases initially.[30] This is an important claim in the pharmaceutical sector, and the pharmaceutical industry is often brought up by national exhaustion proponents to argue against parallel imports. This Article, however, does not address the pharmaceutical problem.

Based on the above two aspects, price discrimination is a socially desirable tool. From here, it is tempting to mistakenly infer that obstacles to price discrimination are bad. If price discrimination is desirable, then parallel importation is arbitrage and will defeat price discrimination, then it is bad, and international exhaustion

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[28] *Id.*

[29] Guy A. Rub, *Rebalancing Copyright Exhaustion*, 64 EMORY L. J. 741, 767-773 (2015). Author states, "the overall effect of price discrimination on the deadweight loss and on the access to the work is usually expected to be modest." (Author states that implementing price discrimination in a low-elasticity market, the price is expected to increase. The price's change increases the producer's surplus but also decrease in quantities, so the deadweight loss increases and the social surplus decreases; however, in high-elasticity market, sellers who implement price discrimination typically choose to reduce prices and increase quantities, then because of the corresponding increase in quantities, so the deadweight loss decreases and increases total surplus. But the total deadweight loss, taking all markets into account, is inconclusive. In most cases, these two effects cancel each other out. But overall, Professor Guy A. Rub think price discrimination is socially desirable).

[30] *See* Keith E. Maskus, *Economics Perspectives on Exhaustion and Parallel Imports*, RESEARCH HANDBOOK ON INTELLECTUAL PROPERTY EXHAUSTION AND PARALLEL IMPORTS (Irene Calboli & Edward Lee eds., 2016).

doctrine allows parallel importation, so it is also bad.[31] Therefore, nations should theoretically choose the national exhaustion doctrine. However, there is a mismatch between prohibiting arbitrage with the solution of the national exhaustion doctrine. Even within the same market, price differentiation can exist on the same commodity. This is arbitrage within a nation's geographic territory. And national exhaustion allows the domestic arbitrage. If arbitrage is the problem that new intellectual property laws should regulate, national exhaustion and international exhaustion are just different types of arbitrage. It seems strange to prohibit just one type of arbitrage (cross-border) and permit another type (domestic).[32] Therefore, taking a reflexive recourse to national exhaustion is unjustified because it is overinclusive. Moreover, even though implementing national exhaustion doctrine supports global price discrimination, investing in different prices and marketing schemes increases cost. Hence, any praise for national exhaustion must be measured against price discrimination investment costs.

C. PARALLEL IMPORTS AND TRADEMARK EXHAUSTION DOCTRINE

Even though international price discrimination is a useful tool to segment the global market, parallel importation is already a global phenomenon, especially under the global trade integration environment. Parallel imports will take up a significant share of trade in the intellectual property rights related goods if permitted within nations.[33] In the trademark area, the conflict between parallel

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[31] *See* Ariel Katz, *The Economic Rationale for Exhaustion: Distribution and Post-Sale Restraints*, RESEARCH HANDBOOK ON INTELLECTUAL PROPERTY EXHAUSTION AND PARALLEL IMPORTS 23, 32-34 (Irene Calboli & Edward Lee eds., 2016).

[32] *Id.*

[33] *See* Nancy T. Gallini & Aidan Hollis, *A Contractual Approach to the Gray Market*, INT'L REV. OF L. AND ECON. 2, 19 (1999) (There are some statistic data cited in the paper, for example, a 1988 estimate of the size of the gray market in the United States was $7 to $10 billion per year;

importation and trademark exhaustion has been solved in many major markets. Most of them implement international exhaustion and permit parallel imports in general. However, to address concerns related to parallel importation (including low product quality, lower-priced products flooding the domestic market, and trademark owners' exclusive right protection), nations have adopted differing mechanisms to protect trademark owners' rights and to balance the consumers' benefit with the trademark owners' benefit. In China, the parallel importation issue appeared rather late, but China is solving the issue and balancing the benefits.

In our daily life, individuals buy luxury products (such as paintings, a Hermès Birkin bag, or a car) in a state with a lower price, and then bring it to a state with a higher price and sell it without catching any attention. So, the individual-level or retail-level parallel imports will not catch the attention of the intellectual property rights owners and producers, and the sellers make a considerable profit from the deal. This kind of behavior is also the starting symptom of *daigou* fever in China.[34] Consumers want to have more shopping choices, and so they will do comparison shopping to choose the lower price tag. In China, the primary categories of *daigou* focus on luxurious products (high-end jewelry and watches, bags, limited-edition products, etc.), clothing, cosmetic products, and daily necessities (diapers, milk powder, etc.). The high tariffs imposed on those products lead to high prices in the Chinese market. To take advantage of this, some will purchase goods abroad (while studying abroad or for work) and sell them back home for a profit. It all starts with price discrimination. *Daigou* is a variation of parallel importation in China. There are

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The U.S. gray market in luxury automobiles grew 2000% between 1981 and 1986 on the tail of considerable dollar appreciation; And as the Japanese yen appreciated at the end of the 1980s, gray imports achieved greater penetration in Japan; Some 60,000 gray market cars were imported from Europe in 1985; Gray market car sales in Germany in 1996 are estimated at over 300,000, implying a minimum of $6 billion in sales.)

[34] *See* Huifeng, He, *"China's Band of Daigou Shoppers Turn to Domestic Sales After Coronavirus Halts Overseas Trips for Luxury Goods"*, Yahoo! News (November 13, 2020).

other issues related to *daigou* behavior, which Section V will address.

With parallel importation, large volumes of parallel import goods are usually organized by parallel import firms which operate at the distributor level. In order to profit from gray market goods, parallel importers need to find a stable supply channel and a reasonable shipping line. They also need to consider the transportation costs, customs costs, and other expenditures needed for importation. The price difference between the two markets has to be big enough, or it will not offset all overhead expenses. Based on these facts, it seems meaningless to argue over the choice between national exhaustion and international exhaustion for less developed countries because parallel importation depends on the existence of considerable price differentials. So, parallel importation usually happens between developed, prosperous countries and less developed countries, like in the *Kirtsaeng* case,[35] which is a textbook parallel importation case between Thailand and the U.S.

The development of economic globalization has bonded various economies increasingly closer, with worldwide free trade being the ultimate goal. The international exhaustion principle increases access to intellectual goods in the market. It provides more shopping choices to consumers so many developing countries are

[35] Kirtsaeng v. John Wiley & Sons, Inc., 568 U.S. 519 (2013) (stating how the Thailand student, Kirtsaeng, moved to the United States for college and stayed through the completion of a Ph.D. program. While living in the U.S., Kirtsaeng had his friends and family in Thailand purchase English version textbooks legally sold in Asian areas and ship those textbooks to him. Kirtsaeng then sold the books at a lower price than the U.S. editions. John Wiley Corp. published academic textbooks in the U.S. and abroad, and books printed in Asia area were licensed to a foreign subsidiary and then manufactured and sold throughout Asia with a copyright notice that limited authorized sale in specific areas, not including the U.S. Then Wiley sued the Kirtsaeng for copyright infringement based on Wiley's exclusive right to distribute the copyright-protected products. This case finally decided by the Supreme Court, held the copyright first sale rule does not contain a geographical limit, and the copyright exhaustion doctrine goes international since this case).

willing to accept international exhaustion, especially in patent areas. In China, intellectual property law is incomplete and parallel importation is a relatively new phenomenon. With the development of the national economy and the intellectual property industry, parallel importation cases have increased, especially for trademarked goods. This phenomenon has been catching people's attention. China implemented the international exhaustion doctrine in the patent area and codified it in the Patent Law, and the international exhaustion doctrine acquiesced in the trademark area through judicial applications. The next section will elaborate on parallel importation of trademarked goods in China.

III. TRADEMARK PARALLEL IMPORTATION IN CHINA

China is a leading nation in exports, one of the biggest manufacturing hubs in the world, and its factory output is used as a key indicator of its global demand. China is known to this day as "the world's factory." Everyone knows the phrase, "Made in China." Many historical changes have taken place in China since the initiation of economic reform and opening up to global trade in 1978. To bring in foreign capital and advanced technologies, China created numerous open door policies. With low labor costs, increased foreign investments and technologies imported from foreign countries, China's economy grew rapidly. However, in the intellectual property industry, compared to the United States and other developed nations and communities, China is lagging behind, and it is an intellectual property importation country.

China is a civil law country. After China became a member of the WTO in 2001, China made efforts to review and revise relevant laws and regulations, even departmental rules at the central government level. While China has been criticized internationally for its lack of intellectual property protections, it has been improving its intellectual property laws and regulating market behavior to respect and protect the rights of intellectual property owners. The principle legislation regarding intellectual property in China is the Trademark Law of the People's Republic of China (PRC), which was adopted at the 24th Session of the Standing Committee of the Fifth National People's Congress on August 23, 1982. The Trademark Law has been amended four times as of 2019. Each amendment revised some statutes and regulations to complete its registration system, enhanced the statutes' enforceability, and

clarified infringement situations.[36] For example, the 2019 revisions clarified the relations between a mark's use in commerce and their registration to prevent malicious trademark registration. However, there is no explicit provision covering trademark exhaustion doctrine or the parallel importation issue.

A. BACKGROUND AND RELATED STATUTES

To date, there is no explicit provision about parallel importation in the Trademark Law to identify the trademark exhaustion doctrine or regulate the parallel importation of trademarked goods, although gray market goods have long existed in China. Since 2013, China has established several Pilot Free Trade Zones. These free trade zones are multi-functional special economic zones that implement special customs supervision policies and favorable tax treatment. In principle, it means that products in these zones are imported, manufactured, and re-exported without intervention by customs.[37] The purpose behind these Free Trade Zones is to adapt to global trade liberalization and integration, promote China's economy and foreign commerce development, encourage exports, and to explore the international market. By 2019, China established eighteen free trade zones. After the first free trade zone was established in Shanghai, China launched a policy concerning parallel importation

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[36] *See* 中华人民共和国商标法 [*Trademark Law of the People's Republic of China*], PEOPLE.CN (Nov. 6, 2019), http://ip.people.com.cn/n1/2019/0704/c192427-31214379.html (China); *see also* 中华人民共和国商标法[*Trademark Law of the People's Republic of China*], STATE ADMINISTRATION OF MARKET REGULATION (Apr. 20, 2020), http://gkml.samr.gov.cn/nsjg/tssps/202004/t20200420_314426.html (China).

[37] 中国自贸区指的是什么 自贸区有哪些及其有什么作用 [*What are China's Free Trade Zones?*], XINHUA SILK ROAD, https://www.imsilkroad.com/news/p/109994.html (China) (last visited Jun. 10, 2020).

of foreign cars.[38] On October 23, 2014, the General Office of the State Council issued an official statement providing suggestions for boosting the nation's imports. In the statement, the government suggested all parties involved in importation optimize import management and "accelerate the trial program for parallel car imports in the Shanghai Pilot Free Trade Zone."[39] The phrase "parallel importation" appeared in this government statement, marking the first official acknowledgment of the issue. Then, the parallel import plan later extended it to other free trade zones, including Guangdong, Tianjin, Fujian.

Through the parallel import program supported by government policy, Chinese consumers enjoy easy access to foreign luxury vehicle brands like Porsche and Land Rover, and their enthusiasm sparked sales amid softening sales in the broader market in 2017.[40] In the first eight months of 2017, auto parallel imports bought from other markets for sale in China surged 47.2% year-over-year to 110,000 units, which is a sharp increase from 16.3% growth in 2016.[41] The goal of this parallel importation car program in the free trade zones is to exploit large price differences between the luxury cars sold in countries like the U.S. and Germany, and those marketed in China.[42] The selling price of luxury cars in the aforementioned countries are cheaper than in the mainland China.[43] These numbers suggest that more and more Chinese consumers enjoy the advantage of parallel imports. Starting from the policy of allowing parallel imported cars, the trademark judicial practices in the People's Courts in China acquiescence in adopting the international

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[38] *State Council Issues Opinions on Boosting Imports*, THE STATE COUNCIL OF THE PEOPLE'S REPUBLIC OF CHINA (Nov. 6, 2014), http://english.www.gov.cn/policies/infographics/2014/11/06/content_281475006256178.htm.

[39] *Id.*

[40] *Parallel Imports Boost Chinese Auto Market*, CHINADAILY.COM.CN, http://www.chinadaily.com.cn/business/motoring/2017-09/25/content_32454382.htm (last visited June 10, 2020).

[41] *Id.*

[42] *Id.*

[43] *Id.*

exhaustion on parallel imported trademarked products, even though there is no specific statute to regulate it.

In the early 2000s, the traditional parallel importation issue was not important in China because trademark parallel importation cases rarely appeared and people barely knew about parallel imports.[44] Over time, consumers began to pay more attention to the authenticity of the products.[45] China values intellectual property and pays more attention on the development of intellectual property. With various economic policies issued and implemented, the economic situation in China is changing rapidly. Now, it is significantly more expensive to buy goods from particular industries in China, due to the high tax levied on imported goods.[46] Thus, the parallel importation issue has become important. More and more international trademark owners have brought lawsuits in China regarding parallel importation.[47] Due to these economic changes, China needs to modify the Trademark Law, define the trademark exhaustion doctrine and explicit parallel importation on trademarked goods, fill in the gaps through trademark legislation, and further develop the Chinese intellectual property system.

When courts come across parallel importation issues, they typically use Section 57 of the Trademark Law to decide the case. Otherwise, they look to other laws like the Chinese Anti-Unfair Competition Law.[48]

> Section 57 provides that: "Any of the following constitutes an infringement of the exclusive right to use a registered trademark: (1) Using a trademark that is identical with a registered trademark in connection with the same goods without the authorization of the owner of the registered trademark; … (3) Selling goods that violate the exclusive right to use a registered

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[44] *Id.*
[45] *Id.*
[46] *Id.*
[47] *Id.*
[48] *Id.*

> trademark; … (5) Altering another party's registered trademark without authorization and selling goods bearing such an altered trademark; … (7) Otherwise causing prejudice to another party's exclusive right to use its registered trademark."[49]

This provision does not mention the right to prevent the importation of trademarked goods, nor does it indicate any trademark exhaustion doctrine.[50] It does not include the relative words, like the trademark owner's exclusive right.[51] However, this statute is important because almost all decisions related to trademark parallel importation cases are adjudicated relative to this statute.

B. TRADEMARK PARALLEL IMPORTATION CASES

There are not many reported[52] trademark parallel importation cases to date. This section will elaborate on some reported cases

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[49] CHINA TRADEMARKS (中国与商标) [Trademark Law] P.R.C. Laws, Sec. 57.

[50] Daniel Chow, *Exhaustion of Trademarks and Parallel Imports in China*, 51 SANTA CLARA L. REV. 1283 (2011) (discussing provisions in Section 57, which was formerly Section 52, of the Chinese Trademark Law remain the same, and do not mention the right to prevent the importation of trademarked goods or trademark exhaustion direction).

[51] *Id.*

[52] There is no official system of case reports in China, therefore many cases have no official records published. What's more, courts do not issue full opinions and rationales containing the reasoning used in decisions, and instead of using simple sentences illustrate main points in the judgment. The facts, rationales of cases used and cited in this article are either come from the reported cases judgments, or known because of short articles written by lawyers, judges, legal scholars, and legal workers work in the intellectual property area. However, there is an official website that people can search cases decisions issued by the Supreme People's Court, and the website is http://www.court.gov.cn/wenshu.html. Because there is

focusing on how courts adopt the international exhaustion doctrine in the trademark area. However, one premise that needs to be clear is the cases decided by lower levels of the People's Court are not binding cases: only cases decided by the Supreme People's Court are binding.[53] However, there is no such case yet. Even though the cases discussed in this Article are not binding cases, they can manifest a trend of the probable direction the Supreme People's Court may take on trademark parallel importation cases. By following these cases, the courts' attitude towards the parallel importation in trademark area becomes clear and consistent, especially after the year 2016. This section is divided into three parts: the first part is cases from 1999 to 2013, the second is cases from 2013 to 2016, and the last part is cases from 2016 to present.

After China became a member of the WTO, China opened more to the world.[54] Many multinational companies chose to establish a subsidiary or an affiliate as manufacturing facilities in China to produce and sell goods in the Chinese market; these companies were enticed by the low labor cost and attractive foreign investment economic policies.[55] A typical situation involving parallel importation may involve a multinational company with a brand owner who has already registered its trademark in China, and the company also established a facility for manufacturing in China, which is wholly owned by the company or as a joint venture with a Chinese partner.[56] Then, the brand and trademark owner licenses its trademark to its joint venture, subsidiary or affiliate in China to produce its trademarked goods for sale either in China or export them to foreign countries.[57] The trademarked goods are then manufactured in China, exported from China, and purchased by a

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no trademark parallel importation case adjudicated by the Supreme People's Court to date, and there are only some guidance comments issued by the Supreme People's Court on the already decided cases, controlling as to why there is no reported case published on this website.

[53] *Id.*

[54] *Id.*

[55] *Id.*

[56] Chow, *supra* note 50, at 1283.

[57] *Id.*

third party in a foreign country who attempts to import them back.[58] Another situation involving parallel importation concerns a Chinese company signing an exclusive license agreement with the trademark owner to use the trademark, produce goods and sell them in China; meanwhile, the trademark owner also signs a license agreement with a third country (for instance, Singapore) and then a third party buys the authorized trademarked goods in the third country and subsequently imports them into China. In these situations, the trademark owner or the exclusive licensee will claim the parallel importation of trademark goods without their consent constitutes an infringement of the trademark owner's exclusive rights because there is no clear statute to regulate this behavior.

The first reported case involving trademark parallel importation was the *Lux* case in 1999. The following section uses cases to show that China's attitude towards parallel importation of trademarked goods has been acquiescent, implicitly applying the international exhaustion regime.

1. 1999 to 2013 — Avoiding the Issue

Lux[59] is the first reported case in China related to parallel imports. The plaintiff, Shanghai Lihua Co., Ltd., was a joint venture between a Netherlands company, Unilever Co., Ltd., and a local Chinese business entity.[60] Unilever registered its "Lux" trademark and its Chinese transliteration trademark "Lishi" (力士) in China. In 1997, Unilever signed a trademark licensing agreement with Shanghai Lihua for the use of its trademark "Lux" and "Lux力士,"

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[58] *Id.*

[59] *Shanghai Unilever Co. Ltd v. Commercial Imp. and Exp. Trading Co. of Guangzhou Econ. and Tech. Developing Dist.*, Hui Zhong Fa Zhi Chu Zi, No. 82, Guangzhou Intermediate People's Court, (1999) [hereinafter *Lux*], http://pkulaw.cn/fulltext_form.aspx?Db=art&Gid=df7e46676f6e0e3ba627d91534159397bdfb&keyword=&EncodingName=&Search_Mode=&Search_IsTitle=1.

[60] *Id.*; Andrea Zappalaglio, *The Exhaustion of Trademarks in The PRC Compared with the US and EU Experience: A Dilemma That Still Needs an Answer*, EURO INTELL. PROP. REV (2016).

and manufactured consumer products and sold them under those two trademarks in China. On October 5, 1998, Unilever entered into a revised agreement with Shanghai Lihua to change the licensing method to exclusive license and also granted the licensee the right to take legal action, including litigation, or any other action the receiving party considers appropriate against any infringement of such right.[61] On June 7, 1999, the Customs Office in Foshan, Guangdong Province discovered and seized 895 boxes of soap bearing the "Lux" trademark that were manufactured in Thailand and imported into China by the defendant, the Guangdong Commercial Import and Export Trading Company, without the plaintiff's consent.[62] The plaintiff brought an action in the Guangzhou Intermediate People's Court seeking an order to stop the defendant importing and selling the goods which infringed on the exclusively licensed right of the plaintiff to use the trademark.[63] After hearing the case, the Court held that the defendant imported the soap without authorization from the plaintiff, and infringed the trademark right and the exclusively licensed right of the plaintiff to use the "Lux" trademark.[64] The defendant argued that the soaps were authorized genuine products, not knock-off goods. The defendant also stated that the soaps were ordered by one Hong Kong company, and that Hong Kong company bought them from BN Marketing Company, which bought them from Supamitl.V. Company, which claimed it is the distributor for the Unilever Thai Holding Company.[65] This case is a typical parallel importation case. However, when this issue appeared in front of the court, the court chose not to face the main issue; instead, the court held that the defendant failed to prove that it had imported the original Lux products and failed to prove that it had made the Lux products under the authorization of Unilever.[66]

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[61] *See Lux*, *supra* note 59.
[62] *Id.*
[63] *Id.*
[64] *Id.*
[65] *Id.*
[66] *See Lux*, *supra* note 59.

In simple terms, the court bypassed the main issue—parallel importation—and chose to decide on whether the defendant gave enough evidence to show those "Lux" trademarked soaps were authorized products. It's hard to explain why the court chose to circumvent the main issue. Maybe, at that time, the court did not realize the *Lux* case was a parallel importation case; it's also possible the court did not feel confident to decide a case with a novel issue because there was no statute and no prior cases. In sum, the court missed the first chance to clarify the parallel importation issue and felt reluctant to deal with it.

The next case related to parallel importation is the *AN'GE*[67] case. An'ge Co., Ltd. France is the owner of the "An'ge" trademark. On October 30, 2000, the plaintiff, Beijing Fahuayilin Commercial Company, signed a contract to obtain an exclusive license for the use of the An'ge trademark on clothing.[68] According to the license agreement, the plaintiff has the exclusive right to use the trademark and sell clothing with the An'ge trademark in the cities of Beijing, Shanxi, Chongqing, Zhejiang, and several other cities and provinces.[69] In April 2001, the defendant opened a counter in Taipingyang Department Store in Chongqing and sold An'ge trademarked clothing. The defendant stated the clothing was imported from Hong Kong Ruijin Company, and Ruijin Company is the "An'ge" authorized distributor in Hong Kong.[70] On August 8, 2001, the plaintiff sued the defendants claiming that the defendants infringed on the plaintiff's exclusive right of selling clothing with the An'ge trademark, and requested the court to stop the unfair competition and compensate the plaintiff for economic losses.[71] The Beijing Basic People's Court held that the plaintiff had acquired the exclusive right, but this exclusive right could not exclude a third party from selling clothing with the same An'ge

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[67] *Fahuayilin Inc. v. Shijihengyuan Inc. & Taipingyang Dep't Store*, Beijing No. 2, Intermediate People's Court (2003), http://www.chinaipmagazine.com/journal-show.asp?779.html.

[68] *See id.*

[69] *See id.*

[70] *See id.*

[71] *See id.*

trademark in the same market.[72] The plaintiff appealed and instead argued under Article 5 of the Anti-Unfair Competition Law based on the same facts.[73] The Beijing Intermediate People's Court followed the lower court in affirming the plaintiff's rights while nevertheless vindicating the defendant. On one hand, the court affirmed that the appellant had acquired the exclusive right to use the An'ge trademark. On the other hand, the court held that the appellee legally bought the clothing, imported it from Hong Kong, and sold it in Chongqing.[74] The court stated that the An'ge clothing sold by the appellee did not cause consumers' confusion regarding the source of the goods and it did not affect the reputation of the An'ge trademark.[75] However, this case was not decided under trademark law because the An'ge French Company did not register its trademark according to the Chinese Trademark Law. So, the plaintiff brought this case under the Anti-Unfair Competition Law because unregistered trademarks are not entitled to protection under the Trademark Law. Finally, the court decided that the appellant's claim was short of legal and factual evidence under the Anti-Unfair Competition Law and affirmed the Basic People's Court decision.[76]

The *An'ge* case was another opportunity for the Chinese court to rule on the issue of parallel importation. The claim under the Anti-Unfair Competition Law was based on business concepts and not on trademark rights, so the court was unable to rule on whether

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[72] *See id.*

[73] *See Anti Unfair Competition Law of the People's Republic of China* (promulgated by the Ministry of Commerce P.R.C. Laws, Sept. 2, 1993, effective Dec. 1, 1993), art. 5 P.R.C. LAWS ("Managers should not use the following unfair methods in their business transactions which can damage other competitors: … (2) to use the specific name, package, decoration of the famous or noted commodities, or use a similar name, package, decoration of the famous or noted commodities, which may confuse consumers distinguishing the commodities to the famous or noted commodities… ").

[74] *See* Fahuayilin Inc. v. Shijihengyuan Inc. & Taipingyang Department Store, Beijing No. 2, (Intermediate People's Ct. 2003) (China), http://www.chinaipmagazine.com/journal-show.asp?779.html.

[75] *See id.*

[76] *See id.*

the trademark owner's rights were exhausted. Even though this case was not decided on the parallel importation issue, this case mentioned the imported clothing that was authorized for sale in another market did not cause consumer confusion, and the defendant's sale in Chongqing was not unfair competition. Based on this case, to regulate gray market goods, the courts should hold that the reason why imported clothing are not infringed goods is because the trademark owner exhausted the exclusive rights after the first sale; however, the trademarks need to be registered in China at first. Maybe around the time this case was decided, parallel importation was not a thorny problem in China and there were not many parallel importation cases; also, the plaintiff, in this case, filed the lawsuit under the Anti-Unfair Competition Law.

Before 2013, there was another case reported about parallel importation—the *Michelin Tires* case.[77] In this case the plaintiff was Michelin, a famous French multi-national company that manufactured tires and had already registered its "MICHELIN" series trademarks in China, which included the "MICHELIN" trademark and its Michelin tires figure that the company used on all its products.[78] Michelin's China affiliate manufactured Michelin branded tires and sold its products in China; however, Michelin also entered into a licensing agreement with a Japanese licensee that authorized the licensee to manufacture and sell the Michelin tires in Japan.[79] In April 2008, the plaintiff found out that the two

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[77] *See* Compagie Generale des Etablissements Michelin v. Tan Guoqiang & Ou Can, (Chang Zhong Min San Chu Zi No. 0073 Civil Written Judgment), (Changsha (Hunan Province) Intermediate People's Ct., 2009) (China), https://www.fahejia.com/view?id=7cd2acfc02de42f2b4f93e00acff467c&userid=3cde0acb16a04cc2bba315ead7e7d846&type=2. [hereinafter Michelin v. Tan Guoqiang & Ou Can].

[78] *See id.*

[79] Huang Hui Huang Yibiao (黄晖 黄义彪), *On Trademark Infringement Related to Parallel Import* (略论与平行进口有关的商标侵权行为), (Mar. 12, 2020, 12:22 PM), https://www.fahejia.com/view?id=7cd2acfc02de42f2b4f93e00acff467c&userid=3cde0acb16a04cc2bba315ead7e7d846&type=2.

defendants, Tan Guoqiang and Ou Can, sold Michelin tires that Michelin China did not authorize, which infringed the plaintiff's exclusive trademark rights.[80] The defendants stated they bought the authorized Michelin tires in Japan, which are cheaper than the locally manufactured tires in China, and then imported the tires to sell in China.[81] The plaintiff sued the defendants in Changsha Intermediate People's Court for an order to prohibit the defendants from importing the gray market tires, to pay compensation for the economic loss, and to make a public apology in the national media to dispel the impact of the infringement.[82] The plaintiff had a registered trademark in China, while the defendants bought the genuine authorized products at a cheaper price and then imported them into China without the plaintiff's consent; this is a typical parallel importation case.[83] However, the court decided the case from an alternative point: the gray market tires had not obtained a Chinese Compulsory Product Certification (the so-called "3C" Certificate).[84] The 3C Certification is a mandatory product certificate regulation issued by government departments implementing unified standards and assessment procedures, unified logo and charges on all products included in the Catalog, and requirements to meet the national safety standard.[85] Tires are included in the Catalog.[86] The court held that, even if the tires were Michelin authorized tires manufactured in Japan, the tires sold by defendants in the Chinese market had not acquired the 3C Certification, which meant that those tires may not have met the Chinese national standard and may have quality and safety issues.[87] If those issues appeared in the process of using the tires, consumers would attribute the problems to Michelin Company, which would

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[80] *Id.*

[81] *Id.*

[82] *Id.*

[83] *See id.*

[84] *Id.*

[85] *CCC Mandatory Products*, MPR CHINA CERTIFICATION, https://www.china-certification.com/en/list-of-ccc-mandatory-products/.

[86] *See id.*

[87] Yibiao, *supra* note 79.

jeopardize Michelin's goodwill in China.[88] Therefore, the court held that the importation of those gray market tires would cause prejudice to the exclusive right of the owner of a registered trademark based on §§ 52(2) and (5)—now §§ 57(2) and (5)—of the Trademark Law.[89]

In the *Michelin* case, the court bypassed the crucial point and decided based on a sub-prime issue. However, if the defendants got the mandatory 3C Certification and sold the imported gray market tires, could we consider those tires to have not infringed the trademark owner's exclusive rights? Some Chinese scholars think this *Michelin* case indicated that, as long as those Michelin tires satisfied the Chinese national safety standard, they did not cause consumer confusion and did not cause prejudice to the goodwill of the company; thus, parallel importation is allowed in China. This leads to the next case, the *Victoria's Secret* case, and next era of parallel importation law, from 2013 to 2016.

2. 2013 to 2016 — Heightened Controversy

It seems that the number of parallel importation cases heard in the courts have been increasing since 2013. The attitude towards the trademark exhaustion regime is becoming clearer, but there is still confusion in legal practice. *Victoria's Secret* is an example case for this period.[90] In this case, the plaintiff Victoria's Secret registered many trademarks related to its brand under many classes, including "Victoria's Secret" and its transliteration into Chinese, "Victoria's Secret Pink."[91] The plaintiff did not open retail

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[88] *Id.*

[89] *See id.*

[90] Weiduoliyade MiMi Shangdian Pinpai Guanli Youxian Gongsi Yu Shanghai JinTian Fushi Youxian Gongsi Shangbiaoquan Ji Buzhengdangjingzheng Jiufen An (维多利亚的秘密商店品牌管理有限公司与上海锦天服饰有限公司侵害商标权及不正当竞争纠纷案) [Victoria's Secret Stores Brand Management, Inc. v. Shanghai Jintian Clothing, LLC.], (2012) Hu Er Zhong Min Wu (Zhi) Chu Zi No. 86 (Shanghai No.2 Intermediate People's Court 2012) (China).

[91] *Id.*

businesses in China at that time, and the plaintiff found out the defendant, Shanghai Jintian Clothing LLC, was selling products online under those marks.[92] The plaintiff sued the defendant for infringing its exclusive trademark right and stated the defendant's business behavior constituted unfair competition and false advertisement, so the plaintiff requested an order to stop the defendant's infringing behavior and compensate the plaintiff's economic loss.[93] The defendant argued that all the products were bought from the Victoria's Secret parent company, Limited Brands, Inc. (LBI), and all the products were genuine products that were authorized to use the Victoria's Secret series of trademarks.[94] The court held that even though the wholesale method that the defendant used to sell through the Internet violated the contract with LBI, the sales of goods were authentic goods that were parallel imported after being purchased from the authorized company.[95] However, the complaint did not include a breach of contract claim. Therefore, the court held that the defendant's actions did not constitute an infringement on the plaintiff's exclusive trademark rights.[96] The court upheld the unfair competition and false advertisement claims because the way that the defendant advertised caused consumers' confusion to believe the defendant was the only designated general distributor of the Victoria's Secret brand.[97]

From the parallel importation aspect, the court decided in favor of the parallel importer in this case. In comparison to the plaintiff in *Michelin*, Victoria's Secret does not need to apply for certification to prove the quality of their products. As long as the gray market goods are genuine products, there is no consumer confusion and no damage to trademark goodwill, and there are no material differences between the gray market goods and other authorized products that sell in the domestic country, the parallel imported goods are allowed in China. To be honest, it seems the attitude towards the trademark

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[92] *Id.*
[93] *Id.*
[94] *Id.*
[95] *Id.*
[96] *Id.*
[97] *Id.*

parallel importation in the *Michelin* case is the same as in the *Victoria's Secret* case besides the certification requirement. Because there is no statute to clarify the approach, the court felt there is not enough standing to rule on this issue. All the cases were not decided by the Supreme People's Court, so there is no binding effect. Furthermore, there is no judicial interpretation issued by the Supreme People's Court with regard to parallel importation cases. Therefore, the courts in different provinces accidentally choose to hear the case from side issues.

Following the *Victoria's Secret* case there are several other cases about parallel importation. The *J.P. CHENET* case[98] is about parallel imported wine that the defendant, Monte International Trade (Tianjin) Co. Ltd., bought from an English company, Castillon International Ltd., which got the authorized genuine products from the plaintiff's authorized English distribution company.[99] The plaintiff, the French company Les Grand Chais De France S.A.S., registered its trademark, J.P. CHENET, in China and authorized Dynasty (Tianjin) Co. as the exclusive distributor in China to sell its products.[100] The plaintiff claimed that the defendant's imported wine was different in many aspects from the wine authorized to sell in the Chinese market, including the wine's quality grade, composition, expiration date, price, and after-sale service.[101] So, the plaintiff brought a lawsuit against the defendant for infringing its exclusive right to the trademark and requested an order to stop the defendant from importing and selling J.P. CHENET wine and to stop using J.P. CHENET trademark or any other similar marks on any product packaging, advertisement, and any other promotional materials.[102] The court found that it was the brand owner's right to produce different quality levels, different series,

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[98] 法国大酒库股份公司诉慕醍国际贸易（天津）有限公司侵害商标权纠纷案—平行进口中的商标侵权判定 [Les Grand Chais De Fr. S.A.S. v. Monte Int'l Trade (Tianjin) Co., Ltd.], 2012, (Tianjin Interm. People's Ct. Nov. 3, 2015) (China).

[99] *Id.*

[100] *Id.*

[101] *Id.*

[102] *Id.*

and different types products, and the brand owner's right to sell to different markets with the same or different marks.[103] The defendant's imported wine was an authorized genuine product in England, and the defendant declared the wine at customs in China.[104] Moreover, the court stated that there was no consumer confusion, and it was the consumers' choice to buy which kind of J.P. CHENET wine.[105] Therefore, there was no trademark infringement. The Tianjin Intermediate People's Court allowed the parallel imported wine.

In sum, even though there were differences between the imported products and the products authorized to sell in the domestic market, the courts upheld the parallel importer. Those small differences were not material enough to cause consumer confusion and affect the trademark's goodwill.

During this period, there are several other parallel importation cases, such as Gucci *v. Shanghai Milan Outlet* (2013), *Prada v. Xinjiang Shenshi Trading Co.* (2015), and *Fendi v. Shanghai Yilang Co.* (2016). The fact patterns in these three cases are similar.[106] To summarize, the facts are the following: Gucci, Prada, and Fendi are well-known world-famous brand names and trademarks; the defendants in those three cases respectively sell authentic gray market products in different stores without the trademark owners' authorization.[107] In the *Gucci* case, the defendant highlighted the brand name "GUCCI" and "OUTLET GUCCI" in the store's signboard and inside decorations without any other identification to

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[103] *Id.*

[104] *Id.*

[105] *Id.*

[106] Li Jieqian (李婕茜), *An Shui "Quanmin Hai Tao" Shengkuang Xia Pingxingjinkou Faluwenti Ji Zhuyishixiang* (案说"全民海淘"盛况下平行进口法律问题及注意事项 [*The Case Says Parallel Import Legal Issues and Precautions Under the Prosperous Situation of "All-People Overseas Shopping"*], ZHICHANLI (知产力), Apr. 23, 2018, http://news.zhichanli.cn/article/6210.html.

[107] *See generally id*.

differentiate the source of goods.[108] While in the *Fendi* case, which was also in Shanghai, the defendant's store operated in a Shanghai outlet shopping mall, and the defendant used "FENDI" in the store's signboard to indicate that the store was selling Fendi products.[109] The plaintiffs in both cases sued defendants for exclusive trademark rights infringement and unfair competition.[110] Although both cases were in Shanghai, the cases were in different District People's Courts with different results.[111] In the *Gucci* case, the court decided that the defendant infringed the plaintiff's exclusive trademark rights because the defendant highlighted the plaintiff's trademarks without any identification to explain the source of goods.[112] Thus, the defendant mislead consumers to believe that the defendant's store is an authorized business or that the plaintiff invested in the defendant's business.[113] In contrast, the defendant in the *Fendi* case did not infringe on the plaintiff's trademark because the way that the defendant used the Fendi trademark belongs to nominative use, which reasonably indicates that authentic Fendi products are sold in the store, and because the defendant clearly marked its company's information, name, and contact method.[114] The defendant also stated that its business included other brands' products.[115] Furthermore, the *Prada* case's result is similar to the *Gucci* case's result.[116] This is because the defendant's use of the Prada trademark mislead consumers as to the source of the goods and caused customers to misunderstand whether or not there was a business authorization between Prada and the defendant.[117]

The reason why these three cases appear in this section is because the judicial practice regarding parallel importation from

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[108] *Id.*
[109] *Id.*
[110] *Id.*
[111] *See id.*
[112] *Id.*
[113] *Id.*
[114] *Id.*
[115] *Id.*
[116] *See id.*
[117] *Id.*

2013 to 2016 is controversial and unclear. In the three cases above, all of the plaintiffs brought the unfair competition claim with the trademark exclusive right infringement claim.[118] According to Article 6(2) of the latest Anti-Unfair Competition Law of the PRC, unfair competition occurs when one party overuses and takes advantage of a trade name in business without authorization and misleads consumers to believe that there is a connection between the two parties.[119] With the unfair competition claim in the three cases above, all the courts decided that the defendants' business behavior constituted unfair competition, even though they sold genuine gray market products.[120] Since there is no statute on trademark exhaustion, the courts emphasized the unfair competition and tried to use Anti-Unfair Competition Law to regulate the parallel import phenomenon.[121]

In 2016, the Beijing Superior People's Court issued a legal document to clarify some intellectual property legal issues.[122]

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[118] *Id.*

[119] Zhonghua Renmin Gongheguo Fanbuzhengdang Jingzheng Fa (中华人民共和国反不正当竞争法) [ANTI-UNFAIR COMPETITION LAW] (promulgated by the Standing Comm. Of National People's Cong., Nov. 4, 2017, effective Jan. 1, 2018), art. 6, § 2, http://gkml.samr.gov.cn/nsjg/fgs/201906/t20190625_302771.html (China) ("Business operators shall not carry out the following confusing acts to lead people to mistakenly believe that they are products of others or have specific connections with others … Unauthorized use of the names of enterprises (including abbreviations, font sizes, etc.), names of social organizations (including abbreviations, etc.), names (including pen names, stage names, translated names, etc.) that have a certain influence by others").

[120] Jieqian, *supra* note 106.

[121] *See id.*

[122] *See generally* Dangqian Zhishichanquan Shenpan Zhong Xuyao Zhuyi De Ruogan Falv Wenti (当前知识产权审判中需要注意的若干法律问题) [*Several Legal Issues that Need to be Paid Attention to In the*

Trademark parallel importation was one of the included legal issues.[123] The legal document stated that trademark law is not created for trademark owners to monopolize the goods' circulation.[124] The trademark exhaustion doctrine is one of the basic rules of market competition and needs to be designed to promote the free movement of goods.[125] Based on this, if the accused infringing products come from the trademark owner or under his authorization, the trademark owner has already received the commercial value of the trademarked goods from the first sale.[126] The trademark owner cannot prevent others from secondary sales or other reasonable commercial marketing.[127]

3. 2017 to Present — Emerging Consensus

From 2017 to present day, the controversy on trademark parallel importation is calming down, and the growing consensus in the academic and legal community is that trademark parallel importation is not an infringement behavior. They think parallel importers are retailers of legitimate goods. As long as genuine products are not altered in any form, the connection between the trademarked goods and trademark owners is not isolated. Therefore, the resale of legitimate parallel imported goods should be permitted. The *Daio Paper GOO.N* case is a strong example of these principles.

In 2017, Daio Paper Corporation and Dawang (Nantong) Living Supplies Company, Ltd. filed several civil lawsuits in Tianjin and Hangzhou City, which were all based on the parallel imported

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Current IP Trial], ZHONGGUO GUOJIMAOYI CUJIN WEIYUANHUI ZHUANLI SHANGBIAO SHIWUSUO (中国国际贸易促进委员会专利商标事务所) [CCPIT PATENT AND TRADEMARK LAW OFFICE], at Zhishichanquan Xinwen (知识产权新闻) [INTELLECTUAL PROPERTY NEWS], May 7, 2016, https://www.ccpit-patent.com.cn/zh-hans/node/3197.

[123] *Id.*

[124] *Id.*

[125] *Id.*

[126] *Id.*

[127] *Id.*

"GOO.N" diapers.[128] Daio Paper Corp. (Daio) registered its GOO.N trademark in China under class 16 for facial tissue, toilet paper, diapers, etc.[129] In 2015, Daio signed a trademark licensing contract with Dawang (Nantong) Living Supplies Company, Ltd (Dawang) and licensed Dawang to exclusively use the GOO.N trademark in Mainland China.[130] That same year, the plaintiffs Daio and Dawang discovered that the defendants sold GOO.N diapers online on websites "Tmall.com" and "Taobao.com."[131] The plaintiffs then filed several lawsuits in two cities, Tianjin and Hangzhou, all including the same claim that the parallel imported diapers are materially different from the diapers sold in Japan and it infringed the plaintiffs' trademark exclusive rights based on Section 57 of the Trademark Law.[132] The material differences in the claim mainly include the diapers' permeability index and the after-sale service.[133] However, the Tianjin No. 2 Intermediate People's Court and the Zhejiang Superior People's Court decided that there was no essential difference between the parallel imported diapers and the domestic diapers sold in Japan, including the trademark logo, diapers packaging, and the quality of the products.[134] As to the difference of the permeability index, the courts held that this index

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[128] *Daio Paper Co. v. Tianjin Senmiao Import&Export Co., Ltd*., (2017) Jin 02 Min Zhong No. 2036; *Daio Paper Co. v. Hangzhou Jun'ao Trading Co. Ltd*., (2017) Zhe Min Shen No. 1714. The Civil Written Judgment come from the China Judgement Online websites: https://wenshu.court.gov.cn/website/wenshu/181107ANFZ0BXSK4/index.html?docId=5d8961f58abb43dd9c8da7a600e5f35f; and https://wenshu.court.gov.cn/website/wenshu/181107ANFZ0BXSK4/index.html?docId=1e1a2214c3564dca8bf0a8db009e398b.

[129] *Id*.

[130] *Id*.

[131] Taobao.com is a Chinese online shopping website, headquartered in Hangzhou, and owned by Alibaba. It is analogous to eBay.com or Amazon.com in the U.S. Taobao Marketplace facilitate consumer-to-consumer retail by providing a platform for small business and individual entrepreneurs to open online stores that mainly cater to consumers in China and abroad, which is made payable by online cellphone accounts.

[132] *See Parallel Imports Boost Chinese Auto Market, supra* note 40.

[133] *See supra* note 128.

[134] *Id*.

belongs to diapers permeability quality index and is only one of the other several quality indexes of diapers, and the most important thing is the parallel imported diapers' index on permeability meets the Chinese standard on diapers.[135] So, parallel imported diapers are qualified products. Moreover, as to the after-sale service, the plaintiffs claimed that they have a whole system of after-sale service that the parallel importers cannot supply, and it is going to affect the trademark goodwill if the consumers have issues after they bought the parallel imported diapers.[136] On this point, the courts held that even if the after-sale service is different, the consumers have the expectations for after-sale service when they choose to buy the parallel imported diapers, which means the consumers knew the products are parallel imported, so it will not derogate the trademark value.[137] In conclusion, the courts held that the parallel imported legitimate goods meet the products quality management standards in China, and it provides more shopping choices to domestic consumers.[138] Plus, the parallel importers did not alter the goods, so it will not cause consumers' confusion, and it will not damage the trademark's function of indicating the source of goods and the trademark's goodwill.[139]

With more and more gray market goods appearing in the Chinese market, the parallel importation phenomenon is a known trend and consumers are already familiar with parallel imported products. Consumers have more choices than ever. For instance, they can shop around to find the cheapest price, and they can also get a product that has not been put on the shelf in the Chinese market. The latter example is derived from parallel importation called *daigou* (shopping agents) or *haitao* (overseas online shopping) that will be elaborated on in the last section of this article. It's a parallel importation variation. As previously stated, the parallel importation issue is still in the embryonic stage of

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[135] *Id.*
[136] *Id.*
[137] *Id.*
[138] *Id.*
[139] *Id.*

development in China.[140] Still, the booming international intellectual property trade and the great attention to intellectual property development devoted by the Chinese government require a clear, definite, and transparent statute on parallel importation.[141] If not, it will affect the intellectual property transaction environment, destroy market order, cause consumers' confusion, and damage trademarks.[142] The *daigou* fever discussed in Section V will explain this in further detail.

Before we conclude the discussion of trademark parallel importation, there is one last case. This is the case decided by the Nansha District People's Court within the Guangdong Free Trade Zone.[143] The first time the term "parallel importation" officially appeared in the government documents is when the country began to establish Free Trade Zones.[144] In August 2019, Nansha District People's Court in the Guangdong Free Trade Zone announced its first instance judgment on the initial group of cases on parallel-import-related trademark infringement and unfair competition.[145] The plaintiff in this case, OBD Bettermann (Shenzhen), a wholly-owned subsidiary of the German company, was authorized to exclusively use the two "OBO" trademarks (in different series numbers) in China that were registered in 2006 and 2011 respectively.[146] The plaintiff was also authorized to protect the trademark rights in its name.[147] OBD Shenzhen claimed that all of its lightning protectors were imported from Germany and sold either by itself or by authorized dealers.[148] In December 2017, the

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[140] *See infra* Section VI.

[141] *See infra* Section VI.

[142] *See infra* Section VI.

[143] The First Batch of Trademark Infringement and Unfair Competition Cases Involving Parallel Imports in Guangdong Free Trade Zone Were Publicly Judged, PEOPLE'S DAILY ONLINE (July 30, 2019, 9:35 AM), http://ip.people.com.cn/n1/2019/0730/c179663-31264186.html.

[144] *See id.*

[145] *See id.*

[146] *See id.*

[147] *See id.*

[148] *See id.*

company found that the lightning protectors labeled with the OBO series trademarks were sold by the defendant, Guangdong Shifu Electric Industry Co. Ltd., and used in a large construction project and neither itself nor its dealers were part of the transaction.[149] The plaintiff claimed that the defendant infringed on its exclusive trademark rights and constituted unfair competition.[150] The defendant argued that the products were produced by the enterprises authorized by the OBO Germany and imported from Singapore dealers after clearing customs formalities.[151] They argued further that the products were genuine and authorized to be sold by the trademark owner in Singapore.[152] After the hearing, the court held that the imported products were genuine products and the defendant's importation did not violate any public policy and legal restriction in China, so it should not be assessed negatively.[153] The court also held that the parallel imports did not damage or distort the choices of market players and consumers, thus there was no unfair competition.[154] In conclusion, the court ruled in favor of parallel importers and the plaintiff in this case appealed.[155]

Based on the above case study, China recognizes the legal status of parallel imports by adopting the international trademark exhaustion in judicial practice.[156] Trademark owners' claims may not be upheld by courts to prohibit parallel imports as long as those parallel imports are authorized products sold in other markets and have not been altered or modified.[157] However, as a civil law country, there are many other details that need to be defined on the trademark parallel importation issue in China, like the products' material differences, repackaging issues, Chinese product national

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[149] *See id.*
[150] *See id.*
[151] *See id.*
[152] *See id.*
[153] *See id.*
[154] *See id.*
[155] *See id.*
[156] *See id.*
[157] *See id.*

standard issues, damages, relief issues, etc.[158] The trademark exhaustion statute needs to clarify the general international exhaustion approach adopted by Chinese trademark law and extend to further details of the rule. For example, to what degree can the material differences be accepted on parallel imports? What categories of parallel imports need to meet Chinese national product quality standards, if any? Before we proceed to the proposed trademark exhaustion statute, I will discuss how the trademark exhaustion doctrine works in other countries, as it seems Chinese courts took on some approaches from other countries.

IV. HOW TRADEMARK EXHAUSTION WORKS IN MOST COUNTRIES

A. TRADEMARK EXHAUSTION IN THE UNITED STATES

Historically, the exhaustion doctrine "dates back to the late nineteenth century, when the unprecedented economic change led to a rise in product manufacturing and the growing availability of commercial goods."[159] Trademark owners attempted to use exclusive trademark rights to further control downstream commercial sales after the initial sale.[160] To counter this attempt, North America and Europe reached, at first, the conclusion that manufacturers could not use trademark rights to further control purchasers' rights on subsequent sales activities.[161] After the initial sale, the purchasers are free to dispose of their property.

The limitation of trademark owners' rights is imposed upon trademark owners by the principle of trademark first sale or trademark exhaustion. The trademark exhaustion principle "preserves an area for competition by limiting the producer's power to control the resale of its product."[162] After the first sale, the

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[158] *See id.*

[159] Calboli, *supra* note 10, at 1251.

[160] *See id*. at 1251-52.

[161] *See id*.

[162] *Sebastian Int'l, Inc. v. Longs Drug Stores Cor*p., 53 F. 3d 1073, 1075 (9th Cir. 1995).

trademark owners gain rewards and goodwill associated with the quality of their products. The consumers get what they bargained for—the genuine product—and they will not be confused about the products' identification.[163] The case is going to be different if the third party altered the quality of the marked product without the trademark owner's consent after the first sale.[164]

In the U.S., importation of genuine goods with U.S. protected trademarks is generally permitted as long as there is no consumer confusion about the origin or quality of the imported goods. The U.S. adopts the international exhaustion regime in trademark law. In *K Mart Corp. v. Cartier*, the Supreme Court held that a U.S. Customs Service regulation, promulgated by the Secretary of the Treasury, "permit[s] the importation of certain gray-market goods where (1) both the foreign and U.S. trademarks are owned by the same person or business entity, or (2) the foreign and domestic trademark owners are a parent and subsidiary companies or are otherwise subject to common ownership or control, or (3) the trademark is applied by an independent foreign manufacturer under the authorization of the U.S. owner."[165] Moreover, Sections 32, 43, and 42 of the U.S. Lanham Trademark Act (Lanham Act) provide the provisions that regulate trademark infringement and importation of trademarked goods. Section 32 allows civil action for the U.S. registered trademarks;[166] Section 43(a) mainly stipulated civil action for the unregistered trademarks;[167] Section 43(b) is about importation—it gives the trademark owners the right to block importation or refuse entry when any goods marked or labeled in contravention of the provisions of this section and the goods are likely to confuse consumers or infringe or dilute the registered or unregistered trademarks.[168] Section 42 authorizes the U.S. Customs and Border Protection (CBP) to prevent importation of goods that

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[163] *See id.*; *see also* Calboli, *supra* note 10, at 51.

[164] *Id.*

[165] K Mart Corp. v. Cartier, 486 U.S. 281, at 289 (1988); 19 CFR 133.21 (c)(1)-(3).

[166] 15 U.S.C.A. § 1114.

[167] 15 U.S.C.A. § 1125(a).

[168] 15 U.S.C.A. § 1125(b).

infringe on the registered or unregistered U.S. trademarks.[169] Additionally, the "Lever-rule," which comes from the case *Lever Bros. C. v. United States,*[170] also helps trim the edges of importation and exhaustion rules. The Court's conclusion allowed the trademark owners to bar the importation of gray market products when the products "differ materially" from the goods authorized for sale domestically in the U.S., "regardless of the trademark's genuine character abroad or affiliation between the producing firms."[171]

But what triggers the material difference doctrine which blocks parallel importation? The U.S. courts held that even "subtle differences" are enough because there is a "low threshold of materiality."[172] Any higher threshold would endanger a manufacturer's investment in product goodwill and unduly subject consumers to potential confusion by splitting the connection between the trademark and its associated product characteristics.[173] This also violates the original intention of trademark law. The courts said there is no mechanical way to determine the point at which a difference becomes "material," and it's like "separating the wheat from chaff," which "must be done on a case-by-case basis."[174] For example, material differences have been found in cases including chocolates with different shapes;[175] minor differences in

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[169] 15 U.S.C.A. §1124 (1999).

[170] Lever Bros. Co. v. United States, 877 F.2d 101 (DC Cir. 1989); Lever Bros. Co. v. United States, 981 F.2d 1330 (DC Cir. 1993).

[171] *Lever Bros*., 981 F.2d at 1339.

[172] Zino Davidoff SA v. CVS Corp., 571 F.3d 238, 246 (2d Cir. 2009) ("In the context of gray-market goods, in comparing the trademark holder's product with the gray-market product, we apply a low threshold of materiality, requiring no more than a slight difference which consumers would likely deem relevant when considering a purchase of the product."); Mary LaFrance, *Wag The Dog: Using Incidental Intellectual Property Rights To Block Parallel Imports*, 20 MICH. TELECOMM. & TECH. L. REV. 45, 53 (2013).

[173] *See* Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F. 2d 633, 641 (1st Cir. 1992).

[174] *Id*.

[175] *Id.*; *see* LaFrance, *supra* note 172, at 53.

ingredients and packaging between versions of deodorant soap,[176] different packaging and labeling,[177] different advertising participation and marketing methods,[178] quality control differences,[179] and even dolls with Spanish adoption papers.[180] Therefore, to protect the domestic trademarks' goodwill and reputation, identify the products' bloodline, and avoid the consumers' confusion, the U.S. courts will consider "subtle differences" in trademarked goods as material in gray-market goods importation.

Section 42 of the Lanham Act allows the trademark owner to block parallel importation goods with the help of Customs and Border Protection by using the "Lever-rule" strategy. According to Title 19 Customs Rules, trademark owners need to apply in writing for protection with the Customs and Border Protection by proving that the products are physically and materially different from those authorized for domestic sale. Moreover, trademark owners who assert physical and material differences exist must state the basis for such a claim with particularity, and must provide competent evidence and summaries of physical and material differences for publication.[181] In addition to case law and the Lanham Act provisions, Section 526 of the 1930 Tariff Act also regulates the

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[176] *Id*. (citing *Lever Bros*, 877 F.2d at 108).

[177] *Id*. (citing Ferrero U.S.A., Inc. v. Ozak Trading, Inc., 753 F. Supp. 1240, 1247-1249 (D.N.J. 1991)).

[178] *Id*. (citing PepsiCo, Inc. v. Giraud, 7 U.S.P.Q. 2D (BNA) 1371, at 1373, (D.P.R. Mar. 14, 1988)).

[179] Iberia Foods Corp. v. Romeo, 150 F.3d 298, 304 (3d Cir. 1998).; *see* LaFrance, *supra* note 172, at 53.

[180] *Id*. (citing Original Appalachian Artworks, Inc. v. Granada Elecs., Inc., 816 F.2d 68 (2d Cir. 1987)).

[181] 19 C.F.R. §133.2(e) (1999). "CBP determination of physical and material differences may include, but is not limited to, (1) specific composition of both the authorized and gray market products(including chemical composition); (2) formulation, product construction, structure, or composite product components, of both the authorized and gray market product; (3) performance and/or operational characteristics; (4) differences resulting from legal or regulatory requirements, certification, etc.; (5) other distinguishing and explicitly defined factors that would likely result in consumer deception or confusion as proscribed under applicable law."

importation of trademarked goods. Section 526(a) prohibits the importation of authorized goods without the written consent of the trademark owner, even without showing material differences or likelihood of confusion, but the trademarks are the registered trademarks owned by U.S. citizens, corporations, or associations. However, the regulation furnishes a "common-control" exception from the ban, permitting the entry of gray-market goods manufactured abroad by the trademark owner or its affiliates.[182] What's more, unlike the Lanham Act, Section 526 applies to the importation of foreign manufactures,[183] which means goods that are manufactured outside the U.S. The original purpose of Section 526 was to protect domestic companies, because the trademark holder usually sold to the foreign manufacturer an exclusive right to use the trademark in a particular location with the condition that the foreign manufacturer would promise not to import its trademarked goods bearing the identical trademark back to the United States.[184] This provision, together with Section 42 of the Lanham Act, does not apply to the importation of articles accompanying any person arriving in the U.S. when such articles are for personal use and not for sale.[185] The major disadvantage of using the Tariff Act as a remedy against parallel imports is the requirement that the U.S. trademark owner cannot also own the trademark (directly or through an affiliate) in the country of the manufacturer, because of the "common-control" exception.[186] So, most U.S. trademark owners would find it disadvantageous to assign foreign rights in a valuable mark.[187]

Even though trademark law adopts the international exhaustion regime, and it seems that the U.S. permits parallel importation of

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[182] K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 288 (1988).

[183] 19 U.S.C. §1526(a) (2012).

[184] K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 287 (1988). *See* Mary LaFrance, *Using Trademark Law to Override Copyright's First Sale Rule for Imported Copies in the United States*, RESEARCH HANDBOOK ON INTELLECTUAL PROPERTY EXHAUSTION AND PARALLEL IMPORTS (Irene Calboli & Edward Lee eds., 2016).

[185] 19 U.S.C. §1526(d)(1) (2012).

[186] *See* LaFrance, *supra* note 184.

[187] *Id*.

genuine trademarked goods. There are still many bars that impede gray-market goods access to the U.S. market. The "material difference" exception is commonly used by trademark owners. However, parallel importers can overcome the "materially difference" bar by attaching a proper label with a prominent disclaimer.[188] According to the Customs and Border Protection Rule §133.23, the material differences can be cured by a proper label stating: "[t]his product is not a product authorized by the United States trademark owner for importation and is physically and materially different from the authorized product."[189] The disclaimer must be "conspicuous and legible" and must remain on the product "in close proximity to the trademark as it appears in its most prominent location on the article itself or the retail package or container" until "the first point of sale to a retail consumer in the United States."[190] It seems that proper labeling helps eliminate consumers' confusion and fits the trademark law's function of indicating the source of goods.

The law (case law and statute provisions) on trademark parallel importation is explicit, and there is no controversy about this issue in the United States. The formation of this rule (international trademark exhaustion in general with "materially difference" as an exception) relied on the trademarks' functions. The premise is that trademarks indicate the original source of products, avoids consumers' confusion, and guarantees the products' quality. Therefore, as long as consumers are not confused about the trademarked product and its original source, and the trademarked product has not been altered, the parallel imports are generally permitted.

B. TRADEMARK EXHAUSTION IN THE EUROPEAN UNION

This section describes the use of trademark exhaustion doctrine in the European Union as a whole, not of any individual member

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[188] 19 C.F.R. §133.23(b).
[189] *Id.*
[190] *Id.*

state within the EU or European Economic Area (E.E.A.).[191] The trademark exhaustion doctrine adopted within the EU and E.E.A. is regional exhaustion. This territorial trademark exhaustion has been harmonized and qualified through the EU Member States or E.E.A. market. Trademark exhaustion will be triggered after the initial sale within the EU and E.E.A. In 1957, six European nations signed the treaty establishing the European Economic Community (EEC). One of the provisions in this treaty is Article 85,[192] which prohibits "any agreements between enterprises that are likely to restrict competition within the common market."[193] The underlying economic policy was the creation of an internal European market, as well as the protection and integration of this internal market "without internal frontiers in which the free movement of goods, persons, services and capital is ensured in accordance with the

[191] European Economic Area (EEA) was established via the *Agreement on the European Economic Area*, an international agreement which enables the extension of the European Union's single market to member states of the European Free Trade Association (EFTA). The EEA links the EU member states and three EFTA states (Iceland, Liechtenstein, and Norway) into an internal market governed by the same basic rules. *See European Economic Area*, WIKIPEDIA, https://en.wikipedia.org/wiki/European_Economic_Area.

[192] Article 85 of the Treaty Establishing the European Economic Community, Article 85(1), "The following shall be deemed to be incompatible with the Common Market and shall thereby be prohibited: any agreements between enterprises, any decisions by associations of enterprises and any concerted practices which are likely to affect trade between the Member States and which have as their object or result the prevention, restriction or distortion of competition within the Common Market, in particular those consisting in: (a) the direct or indirect fixing of purchase or selling prices or of any other trading conditions; (b) the limitation or control of production, markets, technical development or investment; (c) market-sharing or the sharing of sources of supply;…" Mar. 25, 1957.

[193] Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 3; *See* Kaoru Takamatsu, *Parallel Importation of Trademarked Goods: A Comparative Analysis*, 57 WASH. L. REV. 433, at 447 (1982).

provision of the Treaties."[194] This economic policy summarizes the relevant EU treaties and EU competition law. The exhaustion doctrine is further mandated by EU primary law forbidding the partitioning of the internal market, particularly Article 34 and 36 of the Treaty on the Functioning of the European Union (TFEU), which is a goal shared by EU competition law.[195]

The free movement of goods is a cornerstone of the internal market's effectiveness, and it was held to be an overarching policy promoted by European competition law.[196] In the early stage of this competition policy development, the European Court of Justice (E.C.J.) was adamant that a national trademark owner could not prevent the importation of goods bearing an identical mark that was lawfully marketed in the country of origin by virtue of its exclusive right.[197] Additionally, the exhaustion doctrine was meant to eradicate any possible restraints on the free flow of trade and competition raised by the exercise of national intellectual property rights, prioritizing an effective regional market with an undistorted competition system first.[198]

Before trademark law harmonization in Europe, trademark rights were territorial and individual Member States adopted their own trademark registration methods and exhaustion regimes. Before adopting the First Council Directive 89/104/EEC relating to trademarks in 1988, the E.C.J. used the competition law provisions of the TFEU, then the Treaty Establishing the European Economic

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[194] Consolidated Versions of the Treaty on European Union and the Treaty on the Functioning of the European Union, Official Journal C 326, 26/10/2012 P. 0001-0390, Article 26 (Ex Article 14 TEC), https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A12012E%2FTXT.

[195] *See id*.; Apostolos G. Chronopoulos & Spyros M. Maniatis, *Trademark Exhaustion and Its Interface with EU Competition Law*, RESEARCH HANDBOOK ON INTELLECTUAL PROPERTY EXHAUSTION AND PARALLEL IMPORTS (Irene Calboli & Edward Lee eds., 2016).

[196] *See* Chronopoulos & Maniatis, *supra* note 195, at 344.

[197] *See id*.; Case 192/73, Van Zuylen Frères v. Hag AG, [1974] E.C.R. 731, 744, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61973CJ0192#SM.

[198] *See id*.

Community (EEC Treaty), to decide trademark cases.[199] So, before the harmonization, parallel imports were not allowed due to the national frontiers. However, the free movement of goods, the competition policy, and the further integration of the EU market were the primary objective, so this required the courts to reconcile conflicting rules and find the balance between policymaking and interpretation of the law.[200] Gradually, in parallel with the growth and strengthening of the common market, the approach of the court shifted towards the core of each intellectual property right, and E.C.J. took the trademark function jurisprudence by reference to the essential function.[201] The essential function is "to indicate the origin of the [marked] product."[202] Furthermore, "the proprietor of the trademark has the right to use that trademark for the purpose of putting a product into circulation for the first time and therefore to protect him against competitors wishing to take advantage of the status and reputation of the trademark by selling products illegally bearing that mark."[203] At this stage, "trademark exhaustion becomes subjected to a 'rule of reason' analysis directed at balancing all the interests involved in cases of parallel importation, much like a theory of unfair competition."[204] In the case *Hoffmann-La Roche & Co. A.G. v. Centrafarm*, the E.C.J. decided, based on Article 36 of TFEU, to recognize that "a trademark proprietor is entitled to prevent an importer of a trademarked product, following repackaging of that product, from affixing the trademark to the new

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[199] 2012 O.J. (L 101). *See* Ghosh & Calboli, *supra* note 13, at 70.

[200] *See* Spyros M. Maniatis, *Whither European Trade Mark Law? Arsenal and Davidoff: The Creative Disorder Stage*, 7 INTELL. PROP. L. REV. 99, 100 (2003).

[201] *See id*.

[202] *Id*. *See also* Van Zuylen Frères v. Hag AG, *supra* note 197, at 735.

[203] Case C-10/89, SA CNL-SUCAL NV v. HAG GF AG, 1990 E.C.R. I-03711. *See* Maniatis, *supra* note 200, at 100; Chronopoulos & Maniatis, *supra* note 195, at 345.

[204] Chronopoulos & Maniatis, *supra* note 195, at 347.

packing without the authorization of the proprietor."[205] However, the trademark proprietors' right to block imported repackaged trademarked products should never "constitute a means of arbitrary discrimination or a disguised restriction on trade between the Member States," according to Article 36 of TFEU.[206] Moreover, Article 34 of TFEU prohibits "quantitative restrictions on imports and all measures having equivalent effect" between the Member States.[207] Therefore, in promoting free movement of goods, parallel imported genuine trademarked products were permitted in general among Member States, unless the imported products did not share a common origin, or the imported products had been repackaged or altered without trademark proprietor's authorization.[208] However, this rule was not a strict rule. The E.C.J. also developed a more nuanced rule based on it, which is a "Member State may not in principle prohibit the sale in its territory of a product lawfully produced and marketed in another Member State even if the product is produced according to technical or quality requirements which differ from those imposed on its domestic products."[209] The rule further states that "[t]he proper functioning of the common market

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[205] Case 102/77, Hoffmann-La Roche & Co. AG v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH, 1978 E.C.R. 01139, Document 61977J0102, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61977CJ0102.

[206] Treaty on the Functioning of the European Union, art. 36.

[207] Treaty on the Functioning of the European Union, art. 34.

[208] Van Zuylen Freres v. Hag AG, *supra* note 197; Hoffmann-La Roche & Co. AG v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH, *supra* note 205. *See* Ghosh & Calboli, *supra* note 13, at 71.

[209] *See* Case T-120/78 Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein, 1979 E.C.R. 00649, https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A61978CJ0120; *See also* 1980 O.J. (C 256) 2, at 2-3; *See* Ghosh & Calboli, *supra* note 13, at 71.; *See* Case 120/78 Rewe-Zentral AG v. Bundesmonopolverwaltung fur Branntwein, [1979] E.C.R. 00649, Document 61978CJ0120, available on the website: https://eur-lex.europa.eu/legal-content/en/ALL/?uri=CELEX%3A61978CJ0120. *See also* OFFICIAL JOURNAL OF THE EUROPEAN COMMUNITIES, No. C 256/2, 3. 10. 1980, at 2-3.

demands that each Member State also consider the legitimate requirements of the other Member State."[210] The gist of establishing and promoting the integrated European market does not change, so in order to achieve this goal, the harmonious development must go fast and effectively.

Trademark law has been harmonized throughout the EU Member States since the adoption of the First Council Directive 89/104/EEC, then repealed by Directive 2008/95/EC, and recently repealed and replaced by the Directive 2015/2436.[211] The First Council Directive 89/104/EEC established the community-wide exhaustion doctrine. In the course of legal development, the exhaustion rule was codified in European Trademark Directive 2008/95/EC as Article 7 and now replaced by the effective Article 15 of Directive 2015/2436. The exhaustion rule states: "A trademark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Union under that trademark by the proprietor or with the proprietor's consent."[212] Also, "the E.C.J. clarified that Community-wide exhaustion was the only applicable criterion and that national rules providing different exhaustion regimes needed to be amended."[213] However, Article 15(2) states the trademark owners' rights are not exhausted after the first sale if the imported goods are altered, changed, or impaired.[214] Still, the nuanced rule stated in the last

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[210] *Id.*

[211] *See* Ghosh & Calboli, *supra* note 13, at 70.

[212] Directive 2015/2436 of the European Parliament and of the Council of 16 December 2015 (approximating the laws of the Member States relating to trademarks (Text with EEA relevance), O.J. L336/1, Article 15(1) – Exhaustion of the rights conferred by a trademark. Article 15(2) states: "Paragraph 1 shall not apply 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").

[213] *See* Shubha Ghosh & Irene Calboli, *supra* note 13, at 72.

[214] Joined Cases C-427/93, Bristol-Myers Squibb v. Paranova A/S; C-429/93 C.H. Boehringer Sohn, Boehringer Ingelheim KG & Boehringer

paragraph about the exhaustion doctrine still applies: if the imported products are repackaged products but they are the result of trademark owners' marketing strategy, and it is necessary in order to market the products in the Member State of importation, and the importers have not changed or modified the products, the regional exhaustion still works.[215] This is the "mutual recognition" principle and Member States subject to it.[216]

In the *Hoffmann-La Roche* case, the court held that the trademark owner may rely on his rights as the owner to prevent an importer from marketing a product put on the market in another Member State by the owner or with his consent, or where that importer has repackaged the product in new packaging to which the trademark has been reaffixed, unless "(1) it is established that the use of the trademark right by the [owner], having regard to the marketing system which he has adopted, will contribute to the artificial partitioning of the markets between the Member States; (2) it is shown that the repacking cannot adversely affect the original condition of the product; (3) the owner of the mark receives prior notice before the repackaged product is put on sale; and (4) it is stated on the new packaging by whom the product has been

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Ingelheim A/S v. Paranova A/S; and C-436/93 Bayer Aktiengesellschaft and Bayer Danmark A/S v. Paranova A/S, 1996 E.C.R. I-3457, I-3527 (Disscussing the "legitimate reasons" in Article 7(2) of European Trade Mark Directive – replaced by Article 15(2) of the 2015 Trade Mark Directive); Council Directive 2015/2436, art. 15(2), 2015 O.J. (L 336) 13. *See* Shubha Ghosh & Irene Calboli, *supra* note 13, at 72.

[215] *See id*.; Case C-349/95, Frits Loendersloot, trading as F. Loendersloot Internationale Expeditie v. George Ballantine & Son Ltd and Others, 1997 E.C.R. I-06227, https://eur-lex.europa.eu/legal-content/GA/TXT/?uri=CELEX%3A61995CJ0349. ("The Court hold… that the possibility for the owner of trade mark rights to oppose the marketing or repackaged products under his trade mark should be limited only in so far as the repackaging undertaken by the importer is necessary in order to market the product in the Member State of importation. It need not be established, on the other hand, that the trade mark owner has deliberately sought to partition the markets between Member States").

[216] COUNCIL OF THE EUROPEAN UNION, 2000 O.J. C (141) 2, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32000Y0519%2802%29.

repackaged."[217] In sum, the EU's trademark exhaustion is regional exhaustion with the primary objective of the internal market integration and free movement of goods within the EU region.

Based on the above analysis of the trademark exhaustion in the U.S. and EU, the U.S. takes international exhaustion, and EU takes regional exhaustion in the trademark area. Concerning each Member State within the EU/E.E.A., the regional exhaustion is a "quasi-international exhaustion" regime but within the limited geographic area. The U.S. and EU share some commonalities. Firstly, the parallel importation is permitted in the trademark area in general. Secondly, in order to protect trademark owners' rights, the trademark owners still hold the right to oppose imported products if there are differences between the imported goods and other authorized goods. Lastly, they both have correspondent measures as to those imported trademarked products' differences, the U.S. use "proper labeling" to cure the "materially differences," and the EU asserted mutual recognition and the harmonization method to achieve the primary objective.

V. DAIGOU PREVALENCE IN CHINA — DERIVED FROM PARALLEL IMPORTATION

As set forth in the prior sections, parallel importation involves the sale of genuine goods outside of authorized distribution channels in the gray market, and it is a global phenomenon. In recent decades, global economic integration is a growing trend. In the past few years, accompanied by the growth of global business, gray markets' marketing channels are further boosted at the operational level.[218] The rise of e-commerce has been particularly apparent in China over

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[217] *See* Case 102/77, Hoffmann-La Roche & Co. A.G. v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH, 1978 E.C.R. 01139, https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A61977CJ0102; Bristol-Myers Squibb v. Paranova A/S, *supra* note 214, at I-3533-3534. *See also* Ghosh & Calboli, *supra* note 13, at 72-73.

[218] Hai Li et al., *Parallel Importation in a Supply Chain: The Impact Of Gray Market Structure*, 114 TRANSP. RES. Part E: Logistics & TRANSP. REV., 220, 220 (2018).

the past few years. Parallel importation did not only appear on the authorized retailers' level. In fact, third-party parallel importation is also very common in the gray market.[219] For instance, *daigou* (shopping agents), or *haitao* (overseas online shopping) are classic examples of third-party parallel importation. These terms refer to the Chinese nationals who take advantage of their stay or travel overseas to buy goods for their clients in China.

At first, this behavior only existed between friends and families. People asked their friends or other family members to help them buy specific products and bring them back, due to the cheaper prices in foreign countries. Eventually, people saw the potential business opportunity and started businesses reliant on this overseas shopping behavior. They started to travel abroad often, and took advantage of international jobs (e.g., an international airline stewardess), or worked with a friend who is studying or living abroad. They would buy products that are either popular in domestic market or according to their client's needs at a relatively lower price. The main product categories these businesses would import include cosmetic products, luxury goods, clothing, health care products, and baby products. To bring these products home, they either packed the products as their personal luggage or mailed them back through personally mailed parcels. The radical revolution of the Internet promotes electronic commerce. Shopping agents bring products back, add a little bit more on the price but are still cheaper than the domestic market price, and then sell them online. More and more consumers start to shop online because it is very efficient and cost-saving, and they also promote the development of e-commerce.

The main reason for parallel importation is the price difference. Many products imported into China are levied on high tariffs, in addition to the value-added tax and consumption tax that apply, according to the domestic regulations. Besides tax, other fees are also added onto imported goods, such as the freight fees, site or mall rental fees, personnel wages, marketing expenses, and profits. All those fees together constitute high prices of imported products in China. What's more, if a brand's business operation process includes multi-layers commercial agents, whether based on different

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[219] *Id.*

markets or different districts in the same markets, the costs and fees added by the different layers in between will result in an even higher price because every link in the business operation process wants to gain more profit. One typical example is Louis Vuitton's classic Neverfull midsize handbag, which sells for $1390 ($1480-$1510 after tax, depending on different tax rates in different states) in U.S. dollars in the United States, 10,900 RMB in China ($1589), 1,040 euros in France ($1154), and 1,710,000 won in Korea ($1472).[220] The fluctuations in price of this Louis Vuitton Neverfull bag is small all over the world, but China still has the highest price. These higher prices are common with the other luxury products in the Chinese market. That is because the overall tax rate is high in China, and the market is not competitive enough, containing many information asymmetry loopholes. Many world-famous brands take advantage of this weakness and tend to fix a high-price strategy in China when first imported into the Chinese market. Moreover, the extraordinary enthusiasm of domestic consumers for foreign brands leads to even bigger price differences. These huge price gaps force Chinese consumers to shop overseas, which then leads to *daigou* fever.

All commodities imported into China need to pay three types of duty and taxes: customs duties, value-added tax, and consumption tax. The valuation method is cost, insurance and freight (CIF), which means the import duty and taxes payable are calculated on the complete shipping value that includes the cost of the imported goods. According to China's 2020 Customs Tariff Implementation Plan ("2020 China Tariff Schedule") the import and export taxable items remain the same with the 2019 version (8549 items).[221] Customs duties are computed either on an *ad valorem* basis or quantity basis.[222] The former is calculated based on the actual

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[220] *Midsize monogram "Neverfull" price*, LOUIS VUITTON, https://us.louisvuitton.com/eng-us/products/neverfull-mm-monogram-007653 (last visited October 25, 2020).

[221] *See* Xinhua, *China Releases Tariff Schedule for 2020*, ENGLISH.GOV.CN, http://english.www.gov.cn/statecouncil/ministries/201912/30/content_WS5e09fa9ac6d07ec821d3e92d.html (last updated Dec. 30, 2019).

[222] Yan Qi, *Import Duties Relating To Cross-Border E-Commerce In A Chinese Context*, 33 ARIZ. J. INT'L & COMP. L., 263, 266 (2016).

transacted price or value of the imported goods, with certain required adjustments.[223] In 2018, nation's value-added tax reformed to three-tier rate of 16%, 10% and 6% for certain goods.[224] According to the Interim Regulations on Consumption Tax, certain imported goods are subject to consumption tax, which include luxury products like diamond jewelry, high-end watches, yachts, high-end products such as passenger cars and motorcycles, and non-renewable petroleum products like diesel oil.[225] Due to the amount involved in paying the addition of customs duties and the value-added tax, imported goods will normally incur import duties equaling 25-30% of its overseas-transacted price.[226] For example, the consumption tax on imported cosmetics is 30%, so it's not a surprise to see an imported cosmetics product sold in China for double, or even triple, its selling price in its origin country.[227] Due to the large price gap, and with the help of an online shopping environment, the e-commerce trading group gets bigger and bigger.

Due to the growth of cross-border e-commerce trade and the shopping agents, the *daigou* phenomenon is developing rapidly in China, and some problems arise with emerging industry. The first big problem is tax evasion. Those shopping agents, whether they are individuals or small companies, make a living by selling "tax-free" genuine foreign products at a lower price. However, the reason that they can sell those products at a lower price but earn profits at

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[223] *Id.*

[224] The original value-added tax (VAT) was 17% or 13%. Then in 2017, the 13% rate was abolished and led to a structure of VAT with 17%, 11%, and 6%. Then in 2018, with the VAT reform further pressed ahead, the original 17% and 11% tax rates were adjusted to 16% and 10% respectively to form the current three-tier VAT rate schedule of 16%, 10%, and 6%. *See Status of the Value Added Tax Reform in the People's Republic of China*, ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, http://www.oecd.org/ctp/consumption/status-of-the-vat-reform-in-the-peoples-republic-of-china-2018.pdf (last visited Oct. 25, 2020).

[225] *See* Interim Regulations on Consumption Tax of the People's Republic of China, Promulgation Number 539 (2009), State Council of the PRC; Qi *supra* note 222, at 266.

[226] *See* Qi, *supra* note 222, at 266.

[227] *See id.*

the same time is because they circumvent the customs authorities and do not go through the customs declaration process. This behavior is considered smuggling: they bring a large number of products from foreign nations then import them into the domestic market for sale, but in the name of personal use by carrying them in their luggage or by mailing the products directly to the clients without a customs declaration. It is impossible for customs authorities to check every single parcel to catch smugglers.[228] These smugglers often sell these products online through taobao.com, other shopping websites, or their WeChat[229] social media account. WeChat is very convenient for smugglers because they can start by selling within a small circle of friends, and then ask for a recommendation to other users. As the time passes by, the friends' circle grows bigger and bigger, so the small *daigou* business starts to become a large retail business. The *daigou* business becomes more and more popular because people see others make profits in the end. As the business grows, the product categories diversify and expand. The shopping representatives eventually stop importing based on their clients' requests, and instead import popular products according to the sales volume in domestic shopping malls, fashion trends, etc.

The reason this *daigou* phenomenon grows derives from the parallel importation concept, which is that parallel imports are genuine products with lower prices than the domestic authorized-to-sell goods. *Daigou* business builds upon trust and friendship between people, but it gradually becomes a social issue because of the associated tax evasion. But for the exhaustion doctrine it would have been an intellectual property issue. The shopping agents make a big profit at the expense of government tax. Furthermore, some unscrupulous merchants only see the profits in this *daigou* process that cause a lot of problems, including using shoddy, knock-off, and low-quality goods instead of genuine products, false advertising,

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[228] *See id.*

[229] WeChat is a Chinese multi-purpose messaging, social media, and mobile payment App; it is developed by Tencent Holdings, Ltd. It is analogous to Facebook, Instagram, etc. in the U.S.

and fraudulent transactions. The primary reason is because there is no explicit trademark exhaustion statute.

As *daigou* fever spread, the Chinese government became aware of the problem and wanted to stop its spread, as well as regulate the e-commerce activities associated with this practice. China enacted its E-Commerce Law, which came into effect on January 1, 2019 to "safeguard the legitimate rights and interests of all subjects involved in electronic commerce, regulate e-commerce practices, maintain the sound market order," and foster the development of the e-commerce industry in a sustainable and healthy manner.[230] However, it missed the point.

Before the E-Commerce Law was enacted in 2012, a former stewardess, together with others, took goods from the airport without declaring that they carried cosmetics and other goods into the country, and evaded customs tax on imported goods for more than 80,000 RMB (≈$11,429 in U.S. dollars).[231] The prosecutors filed public charges against the stewardess and the two others, accusing them of smuggling common goods.[232] The stewardess was initially sentenced to eleven years in jail at trial, but she filed an appeal in 2013. After a hearing in October 2013, she and her friends were each sentenced to two or three year sentences for evading taxes of over 80,000 RMB (≈$11,429 in U.S. dollars).[233] For the cross-border e-commerce import tax, there are two circumstances that can apply to cross-border e-commerce import: goods purchased from merchants registered in China's cross-border e-commerce network, or goods purchased from any overseas merchant and shipped by a courier company who is able to present three required documents (commercial invoice, airway bill, and proof of payment), and who can take legal responsibility for the import. Personal imports of these types, with a customs value up to 5,000 RMB (≈$715 in U.S.

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[230] E-Commerce Law of the P.R.C., Article 1.

[231] Reports on The Cent. People's Gov't of the P.R.C., *Former Stewardess Smuggling Case Retrial−Term of Imprisonment from 11 years to 3 years*, http://www.gov.cn/jrzg/2013-12/17/content_2549426.htm.

[232] *Id.*

[233] *Id.*

dollars), and where the accumulated transaction value has not surpassed the personal annual limit of 26,000 RMB (≈$3715 in U.S. dollars) are exempt from import duty; imports which exceed these limits will be subject to all duties and taxes.

After the E-Commerce Law came into effect, the regulated e-commerce business activities and the e-commerce business environment became more formal and legitimate. The law also includes some key provisions about intellectual property rights protection in Articles 41, 42, 43, and 45. However, these provisions emphasize intellectual property rights protection, infringement action, and how and what e-commerce platform business operators should do to protect intellectual property rights.[234] There are no clear provisions about regulating (or prohibiting) the *daigou* behavior; all the intellectual property related provisions focus on the intellectual property infringements and standardize the e-commerce shopping environment. Since the enactment of the E-Commerce Law, the supervision system of online-shopping platforms has become more complete and stronger. Platforms like Tmall.com, Taobao.com, JD.com, etc., are under more regularized management—at least when the *daigou* incident happens, people have related laws to rely on because it is not fully unregulated anymore. However, there are no specific provisions about parallel imports, and some wording of the E-Commerce Law is rather broad, like "necessary measures," which is unclear about the definition and scope of "necessary." What's more, even though e-commerce platforms like Taobao.com, etc., are under strict supervision, WeChat is a loophole. Because WeChat is a social network software, it is very difficult to supervise. At least for now, WeChat is still the fairyland for *daigou*. There is no doubt the E-Commerce Law makes progress on regulating e-commerce trade; however, the main issue is still there.

The above statement is the current situation about *daigou* behavior. We can see that the legislation department and governmental administration department tried to regulate this behavior and want to provide a healthy, positive, and clear e-commerce environment for people. However, the *daigou* behavior

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[234] *See* E-Commerce Law of the P.R.C., Article 41-43, 45.

is derived from parallel importation. Intellectual property trade is very important to China. In China, parallel importation is more like a trade problem, rather than an intellectual property issue. Like the U.S., China needs an explicit statute on implementation of the international exhaustion. The highest priority is to enact trademark exhaustion statutes and parallel importation provisions and regulations to fill the missing adequate legal basis on the trademark parallel imports issue. If the legal basis is added, the parallel importation market will be regulated and parallel imports' quality will be more guaranteed, then the *daigou* phenomenon will not need to be worried about in the future.

Two main issues exist in *daigou* activities. The first is tax circumvention. The second is the product quality will not be guaranteed, meaning there are knock-off goods mixed in the authentic products. Unscrupulous merchants use *daigou* as a cover and use free-trade zones' preferential tax policy as a channel, pretending to export those knock-off goods then bring them back sold in the domestic market eventually. Free-trade zones are part of the territory. However, any goods entering this part will be subject to import tariffs, so it is regarded as outside the customs border. The explicit international trademark exhaustion will remedy the *daigou* situation.

The reason for the rise of *daigou* is price differences. After taking the international exhaustion, parallel imports are explicitly permitted. More parallel imported goods will emerge in the Chinese market, and those gray market goods' prices usually will be lower than the authorized products sold in the domestic market. The consumers will have more shopping choices, and they will not need to worry about the authenticity of the goods because parallel imported products are genuine products. Moreover, parallel importers will go through the Customs declaration process, so there will be no product-smuggling risk, and the tax evasion issue will be settled. Imported products sell at a high price in the Chinese market because of the high tax rate. However, China is reforming itself to integrate the world, plus intellectual property trade is very important to China. Many preferential policies implemented in those free-trade zones are to stimulate trade development and encourage exports. Maybe China will lower its high tariff rate and high tax rate again, and then the Chinese market price will decrease. With parallel imports at a lower price and quality guarantee, the domestic product price may be lower in the future, plus the cost of doing

daigou business; therefore, the price gap will be reduced, and profit margins will be cut. When the little profit cannot offset all the costs, this *daigou* phenomenon will disappear.

VI. PROBLEMS WITH CHINA'S CURRENT APPROACH AND PROPOSAL TO CLARIFY THE FUTURE TRADEMARK EXHAUSTION

Based on the background information provided and the parallel importation cases involving trademark law discussed above, China's current approach to parallel importation is evidently problematic.

The first and most fundamental issue is there is no statute in trademark exhaustion or in trademark parallel importation in the Trademark Law. As the trademark parallel importation issue developed to this current situation, China must revise and amend the Trademark Law to fill this gap. Because only rely on those scattered non-binding case decisions, the trademark owners, consumers, and the parallel importers are not clear about the general rule or the exceptions on parallel importation. We need to regulate this phenomenon rather than taking a laissez-faire attitude, or it will cause an adverse effect on the market transactions environment.

From reading the above case history, we can see that a general consensus has been reached, which is trademarked parallel imports are permitted as a principle and prohibited as an exception. However, the above parallel importation cases indicate that there are two hurdles that need to be overcome before suing for infringement of exclusive trademark rights.

The first hurdle is that parallel imported goods are genuine goods, which are authorized to sell in other markets. It seems that the courts will first check whether the imported goods are authentic products imported by parallel importers after clearing customs formalities. The courts think this is the premise to rule on a legitimate trademark parallel importation case. In academia and the legal practice field, there is a phrase called "legitimate parallel

imports."[235] These entities think the legitimate parallel imports will not destroy the trademarks' identification function, nor the trademarks' goodwill.[236] However, there is a misunderstanding about parallel importation. By definition, parallel imports are genuine products that authorized to sell in one country market, which are authorized to be sold in the market of one country and subsequently imported to another country to be sold in that market, all without the consent of the trademark owner or licensee. Parallel imports are not knock-off goods, so courts cannot mix the parallel imports goods with counterfeit products. Therefore, parallel imports are legitimate products. Nevertheless, it is understood why China pays more attention to imported goods' authenticity. China is very sensitive to the perception that it does not respect foreign intellectual property rights, skills, and technologies. There are always voices in the international community criticizing the intellectual property protection in China, so China has been under international pressure to alleviate serious counterfeiting and commercial piracy problems. It is possible that opening the gate and allowing parallel imports into the domestic market will lead to more severe counterfeit and substandard products issue. Under the trademark international exhaustion doctrine, some counterfeiters deliberately use this open gate to manufacture some knock-off goods with the same or similar foreign trademarks in some Southeast Asian countries then import them into China and deceive consumers that the products are parallel imports and not counterfeits. By definition, parallel imports are genuine products. However, based on the current condition of Chinese market, what needs to be clearer is how to verify and prove the legal source of parallel imports—like with license contracts, sales contracts, invoice notes, delivery documents, and so on. This is another aspect that needs to be made clear through legislation. The parallel importation issue is new to China, so it makes sense that Chinese courts will check the authenticity of parallel imports before ruling on other aspects.

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[235] *See* Han Jinwen & Xu Anbi, *A Review of Trademark Infringement In Parallel Imports*, BEIJING ANJIE LAW FIRM, http://news.zhichanli.cn/article/7162.html. (last visited Oct. 11, 2018).

[236] *Id.*

The second hurdle is that the trademark must be registered under the Trademark Law of China, or else litigants cannot sue based on the parallel importation issue. For unregistered trademarks, the Anti-Unfair Competition Law will come into play. As the intellectual property system becomes more complete and as more parallel importation cases arise in China, foreign trademark owners have already registered their trademarks when it comes to trademark infringement cases. Furthermore, the trademark owners will always take the unfair competition claim with the trademark exclusive right infringement claim and try to seek another layer of protection under the no clear trademark exhaustion statute situation.

After the two hurdles have been settled, the trademark parallel imports cases are decided on the following aspects: (1) whether the parallel importer altered the products' packaging or repackaged, changed the original trademark, or used Chinese transliteration of the foreign trademarks on the products without permission (e.g., the J.P. CHENET case); (2) whether the parallel imports met the requirements of products standard[237] in China (e.g., the GOO.N case); (3) whether the parallel imports violate the quality certification required by the mandatory administrative regulations (e.g., the Michelin case); and (4) whether the parallel importers used the trademark more than normative use in business operation process (e.g., the Fendi, Prada, and Gucci cases). It is not limited within those above aspects in reality. The starting point of allowing parallel importation is it will give domestic consumers more

[237] Article 8 of the Product Quality Law of the PRC, "Industrial products constituting possible threats to the health or safety of human life and property must be in compliance with the national standards and trade standards safeguarding the health or safety of human life and property…"; and Article 15 "All marks on the products or the packages thereof shall meet the following requirements: (1) with certification showing that the product has passed quality inspection; … (3) with corresponding indications regarding the specifications, grade of the product, the main ingredients and their quantities contained in the product, where such particulars are to be indicated according to the special nature and instructions for use of the product; [and] (5) with warning marks or warning statements in Chinese for products which, if improperly used, may cause damage to the products per se or may endanger the safety of human like or property…"

shopping choices, and consumers will get a genuine product and benefit from the relatively low price. However, it can be noticed that the methods the courts use to rule on the trademark parallel importation issue is probably inspired by the material differences standard established by the leading case *Lever Bros* of the U.S., and the trademark harmonization standard on parallel importation in the EU area. For now, China is beginning to focus more on the products' authenticity and the differences between the parallel imports and authorized goods sold in Chinese domestic market. If China decides to use the material differences standard, it needs to define the limit of differences and define the word "material."

As the economic policies change rapidly, and with more Free Trade Zones set up, it can be predicted that parallel importation cases will continue to proliferate in the near future. This is because the establishment of the Free Trade Zones officially bring the parallel importation into the legal practice (government issued policy about parallel imported cars). Further, the establishment of the Free Trade Zones is an adaptation to the world trade rules, and it also meets the needs of China's own reforms and development. Thus, it's the right time to revise and amend trademark law to provide a clear way to solve parallel import cases in the future.

With the proliferation of international commerce in China, the parallel importation situation will increase the risk of intellectual property market's instability, if the situation continues. When the parallel importation issue first appeared in the Chinese market, this issue was relatively new. The courts tried to avoid the issue at first and decided the case from another aspect, like the unfair competition. The trademark area takes the international exhaustion direction through the judicial process, but there is no explicit statute yet. The Trademark Law of China needs to be amended and add one or more provisions about the trademark exhaustion regime and parallel importation regulation. Statutes are the legal basis. Parallel importation is more like a trade policy issue in China, especially from the establishment of the Free Trade Zone and the *daigou* phenomenon.

Nevertheless, the root cause of the issue comes from trademark law, which lacks legal basis on trademark parallel importation. Without a legal basis, the parallel importation market will not be regulated normally. It will also increase the consumers' likelihood of confusion as to the authenticity of the trademarked goods. Over

time, it will adversely affect the market order and transaction environment.

Therefore, in proposing the trademark exhaustion doctrine, this Article raises several points that need to be clear in the statute.

First, the future trademark exhaustion statute or parallel importation proposition needs to be clear and transparent on exhaustion doctrine regime.

Second, based on the current intellectual property trade environment in China, it is necessary for courts to add one more method to check parallel imported products' authenticity, even if this is temporary. It will be improved when the intellectual property protection is stronger and more complete.

The third aspect is based on the above case history analysis. It seems courts borrow the material difference technique from the U.S. and try to use it in deciding parallel importation cases. However, the provision needs to be clear on how to judge the material difference and to what extent the differences can be accepted in the Chinese market. For example, whether repackaging counts as a material difference; whether importers add an authorized Chinese transliteration name of the trademark on the original package count as material difference; and whether the imported products need to meet the Chinese national product standard and if they do, there should be a list of product indexes on different kinds of products, and so on.

Fourth, in connection with the previous point, if the parallel imports are found to be materially different from the authorized products marketed in the Chinese market, the law needs to consider whether the proper labeling would cure the differences and dispel the consumers' confusion.

Finally, the future trademark exhaustion provision needs to clarify the relief and damages on trademark parallel importation. As a civil law country, China needs to be clear on the above four aspects in the future statutes to establish a robust legal basis on the trademark parallel importation issue. The *daigou* issue will be solved, and the healthy and regulated trading and commerce environment in the trademark area will keep rolling.

VII. CONCLUSION

This article has analyzed the evolution of the exhaustion doctrine in China's trademark law, inquiring into how parallel imports are regulated and why China needs to enact an explicit trademark exhaustion statute. China's trademark law case history demonstrates that Chinese courts tend to adopt the international exhaustion doctrine in favor of parallel imports. Surprisingly, the Trademark Law of China is still silent on this issue. However, it seems the Chinese courts are inspired by the U.S. and EU approaches in trademark exhaustion, like the material differences rule. With the prosperity of China's international trade, the increasingly accumulated cases adjudications are not enough to distill a general rule on the trademark parallel importation issue. What's more, the establishment of those Free Trade Zones accelerates trade development, and the *daigou* phenomenon thrives in part because of an absence of clear trademark exhaustion statutes and no specific parallel importation policy. Over time, it will not be conducive to market stabilization, and it will increase the risk in international trade. Therefore, the legislature needs to fill the trademark exhaustion gap, and the Trademark Law must be amended as soon as possible. Specifying the trademark exhaustion and parallel importation policy would foster legal certainty when dealing with all the trademarked goods brought to China. After the specific statutes are enacted, *daigou* fever would be regulated and parallel imports would stimulate international transactions for the sake of international trade and business.