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Japanese-Auto Products v. BBS—A Threat to Exacerbate U.S.-Japanese Trade Relations

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JAPANESE-AUTO PRODUCTS V. BBS—A THREAT TO EXACERBATE U.S.-JAPANESE TRADE RELATIONS?

I. INTRODUCTION

Throughout 1995, the Clinton Administration repeatedly met with Japanese officials to negotiate an agreement to improve U.S.-Japanese trade relations.[1] While many White House officials claimed a victory in the resulting "11th-hour" trade pact,[2] several U.S. patent experts were still lamenting a controversial Tokyo High Court decision that may further aggravate already tense U.S.-Japanese trade relations and give rise to a new trade quarrel.[3] In *Japanese-Auto Products v. BBS Inc.*,[4] the Tokyo High Court held that even though a German company owned patents in both Germany and Japan for its product, a Japanese company could legally purchase that product in Germany, import it into Japan, and sell it for profit without violating the German company's patent rights.[5] This ruling departed significantly from long-standing patent practices in most countries, including the United States and Japan;[6] however, a much broader problem overshadowed this decision— a huge trade deficit with Japan. Now that the pact with Japan has addressed the trade deficit problem, U.S. officials must turn their attention to this little publicized case and its consequences.

This Note analyzes *Japanese-Auto Products* and its impact on U.S. companies and the tense U.S.-Japanese trade relationship. Part II introduces the case and discusses its relation to different trademark and

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1. *See U.S., Japan Both Claim Victory in Trade Accord*, CHI. SUN-TIMES, June 30, 1995, at 41 [hereinafter *U.S., Japan Both Claim Victory*].

2. *See id.*

3. *See* Teresa Riordan, *Tokyo Court Ruling Could Set Off New Trade Rift with the United States over Protection of Patents*, N.Y. TIMES, Apr. 17, 1995, at D2.

4. 1524 HANREI JIHO 3 (Tokyo High Court, Mar. 23, 1995), *translated in* Judgment to the Case of NE No. 3272/1994 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

5. *See* Riordan, *supra* note 3.

6. *See id.*

patent[7] concepts, including parallel importation and the "first-sale" doctrine. Part III specifically discusses the impact of the *Japanese-Auto Products'* decision on the concept of parallel importation. Next, Part IV addresses the relationship between the "first-sale" doctrine to the case. Part V briefly reviews the current tension in the U.S.-Japanese trade relationship and the analyzes the decision's effects on this relationship. Finally, Part VI analyzes several practical considerations that critics of the *Japanese-Auto Products* decision have not yet addressed.

II. *JAPANESE-AUTO PRODUCTS V. BBS*: THE DECISION

On March 23, 1995, a three-judge panel of the Tokyo High Court[8] ruled that even though appellee BBS Kraftfahrzeugtechnik (BBS), a German company, owned patents on cast aluminum auto wheels in both the Federal Republic of Germany and in Japan, appellants Japanese-Auto Products Inc. (Japanese-Auto) and Lacimex Japan Company could legally import the wheels made in Germany and sell them in Japan at a higher price without violating BBS' Japanese patent.[9] Consequently, BBS lost its right to profit a second time from a product that it legitimately manufactured.

A. Facts

The parties did not dispute the underlying facts of the case.[10]

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7. A trademark is "a distinctive mark of authenticity, through which the products of particular manufacturers . . . may be distinguished from those of others." BLACK'S LAW DICTIONARY 1493 (6th ed. 1990). A patent is "[a] grant of right to exclude others from making, using, or selling one's invention and includes [the] right to license others to make, use or sell [that invention]." *Id.* at 1125.

"A trademark is not patentable . . . . A trademark gives its owner the right to exclude others from using the same or similar marks in a way likely to cause confusion . . . among [buyers]." DAVID A. BURGE, PATENT AND TRADEMARK TACTICS AND PRACTICE 112-13 (1980). Patents, on the other hand, "are granted on advances in the useful arts, not on symbols, words, or devices that identify and distinguish goods or services . . . . A patent gives its owner a right to exclude others from making, using, or selling a particular [good]." *Id.* Thus, trademarks and patents "give their respective owners different kinds of rights." *Id.*

8. The Tokyo High Court, a court of appeal, is the most important of Japan's eight high courts. *See* ELLIOTT J. HAHN, JAPANESE BUSINESS LAW AND THE LEGAL SYSTEM 19 (1984).

9. *See* Riordan, *supra* note 3.

10. *See Japanese-Auto Products*, 1524 HANREI JIHO 3 (Tokyo High Ct., Mar. 23, 1995), translated in Judgment to the Case of NE No. 3272/1994 at 6 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Com-*

BBS owned the patent rights in Japan and Germany, BBS sold the products in Germany after its German patent became valid, and the aluminum auto wheels at issue fell within the scope of BBS' Japanese patent.[11] The dispute boiled down to whether Japanese-Auto could legitimately profit on the sale of a product in Japan when BBS owned the product's patent.

At the trial court level, the Tokyo District Court[12] ruled in favor of BBS.[13] The district court ordered Japanese-Auto to pay 4.8 million yen (approximately US $59,000) to BBS.[14] This sum equaled the seven percent royalty that Japanese import agencies ordinarily paid to foreign suppliers.[15] Nevertheless, BBS was not content with this ruling.[16] It sought 11.2 million yen in damages (roughly US $110,000) and an injunction against Japanese-Auto from importing BBS' wheels.[17]

B. Arguments on Appeal

Japanese-Auto appealed the district court's ruling. It argued that the aluminum wheels' distribution within Germany exhausted BBS' patent right in Japan.[18] Therefore, its sale of the imported wheels within Japan did not constitute infringement.[19] In effect,

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parative Law Journal).

11. *See id.*

12. Patent infringement cases begin at the district court level. *See* A. AOKI ET AL., JAPANESE PATENT AND TRADEMARK LAW PL3 (1976). In each of the fifty district courts in Japan, one to three judges sit and try the case depending on the complexity of the suit. *See id.* Patent suits usually require three judges. *See id.* The Tokyo and Osaka District Courts are the most important Japanese district courts for patent infringement cases. *See id.* In addition to handling three-fourths of all infringement actions in Japan, these two courts have special patent sections. *See id.*

13. *See* Riordan, *supra* note 3.

14. *See* Victoria Slind-Flor, *Japanese Ruling Upsets Importers and IP Lawyers*, NAT'L L.J., May 1, 1995, at A7.

15. *See id.*

16. *See* Elliott J. Hahn, *Patents: Recent Japanese Ruling on "First-Sale" Doctrine May Exacerbate U.S.-Japan Trade Relations*, CEB CAL. BUS. L. REP., July 1995, at 25.

17. *See id.*

18. *See Japanese-Auto Products*, 1524 HANREI JIHŌ 3 (Tokyo High Ct., Mar. 23, 1995), *translated in* Judgment to the Case of NE No. 3272/1994, at 6 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

19. *See id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 6 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

Japanese-Auto argued that a patent holder has the right to a royalty the first time it sells a product, but loses that right once it sells the product to a third party.[20] This theory is called the "first-sale" doctrine.[21] Japanese-Auto further questioned the legitimacy of allowing BBS to receive a second set of profits beyond the first-sale profits earned in Germany.[22]

On the other hand, BBS maintained that the sale of its product in Germany did not exhaust its Japanese patent right. BBS wanted Japanese-Auto enjoined from importing the wheels to ensure their quality and to secure their safety.[23] Essentially, BBS argued that wheels attached to fast-moving cars require strict quality control to ensure their safety.[24] The court conceded that it had seen cases where faulty packaging and "clumsiness in handling during transit" harmed the wheels, especially when the wheels were parallel imported[25] from overseas.[26] Furthermore, BBS argued that allowing parallel importation of its wheels detracted from the goal of maintaining the quality of patented products and could cause an unexpected loss to consumers.[27] The court acknowledged:

During high speed traveling, wheels are the part (of the auto-

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20. Hahn, *supra* note 16.

21. For a more detailed discussion of the "first-sale" doctrine, as well as its impact and ramifications, see *infra* Part IV.

22. *See Japanese-Auto Products*, 1526 HANREI JIHŌ 3, *translated in* Judgment to the Case of NE No. 3272/1994, at 6 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

23. *See id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 4 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

24. *See id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 5 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

25. Generally, parallel importation occurs when a brand name consumer product, which a trademark or copyright protects, is sold abroad and imported back to the country of origin for resale. For a more detailed discussion of parallel importation, see *infra* Part III.

26. *Japanese-Auto Products*, 1524 HANREI JIHŌ 3, *translated in* Judgment to the Case of NE No. 3272/1994, at 5 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

27. *See id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 17 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

> mobile) where it is subject to extremely strong and complex forces of stress, and one may not deny the probability of even a slight imperfection causing a grave accident. Also, the automobile manufacturer may alter its specification which may necessitate the wheel's specification to be changed. An authorized dealer would normally notify the registered owners (users) of the automobile as a routine part of services to customers and can improve its services by meeting the new specification including those wheels as inventories. It is only the authorized dealers who are capable because it is possible for the authorized dealers to maintain intimate exchange of information with the automobile manufacturer and the wheel manufacturer itself concerning the products and technology, and obviously, because the authorized dealer has sufficient stock of wheel parts (and the like).[28]

Nevertheless, the Tokyo High Court[29] agreed with Japanese-Auto and ultimately rejected BBS' safety argument.[30] The Tokyo High Court stated unequivocally that the inventor's interest should be weighed against the societal need for "development of the industries:"[31]

> When the balance of interests between the two (inventors' vs. public's) are considered with respect to where the due distribution of the patent product above noted, if the effects of a patent right extends to the patent product after due distribution, one should require permission or agreement by the patentee et al on every instance when a transfer of the product is intended, which situation harms the legal (safety) of transactions, hinders

28. *Id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 5 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

29. In infringement cases, the high court hears new arguments, claims, and defenses in addition to reviewing the lower court record, facts, and new evidence. AOKI ET AL, *supra* note 12, at PL4. Appellate court judges frown upon a replay of lower court proceedings and expect litigants to present new arguments. *See id.* The high courts in Japan generally assume a more active role in making final rulings than appellate courts of most Western legal systems. *See id.*

30. *See Japanese-Auto Products*, 1524 HANREI JIHŌ 3, *translated in* Judgment to the Case of NE No. 3272/1994, at 17 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

31. *See id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 10 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

> distribution of the patent products and consequently most clearly impedes the development of the industries. Such extension of the effects of patent rights to a time after and beyond the due distribution sales of the product renders an (unwarranted and) excessive favoring of (legal) power to a patent right, which would cause a loss of harmonious balance with protection of the interests of the public/society to be obtained through development of the industries.[32]

Thus, upon balancing, the court held that "there [were] no rational grounds to allow [BBS] a second opportunity to obtain profit with respect to sales after and beyond the first distribution."[33] The court concluded that it was "due and fair" to consider BBS' rights as "exhausted" by its sales within Germany and that a denial of the requested injunction and damages was consistent with current Japanese patent law.[34] Additionally, the court held that matters concerning the effect on the quality of the patented products "concern the business as a whole as a matter of reliability, and resides [sic] in a dimension foreign to the matter of validity/effects of a patent right which aims to protect conceptions of technology, and one has to say that such arguments are undue."[35]

Lastly, BBS argued that allowing "parallel importation of genuine patent goods will weaken the motivation of obtaining a patent license, will impede the appearance of numerous technology adapted to the requirements of the market and eventually invite monopoly of the world's markets by giant corporations."[36] The court conceded that allowing parallel importation weakens

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32. *Id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 10 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

33. *Id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 11 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

34. *See id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 18 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

35. *Id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 17 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

36. *Id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 16 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

the motive to obtain a patent license.[37] Nevertheless, the court concluded:

> [T]he issue of obtaining a license, or otherwise, to acquire technology under the patent invention, basically relies on the technical value of the patent invention under consideration, development phase of competitive technology, existence of alternatives, production costs of the product manufactured under license, and other relevant matters. So far as parallel imports are concerned, there is obviously a limit to the quantity and price with a genuine patent product which has been duly distributed in a foreign country, and then parallel-imported. Then, under such consideration, the Court cannot consider that approval of parallel importation is a major cause of weakening the motivation of obtaining license and impedes the prolific generation and appearance of numerous technology. Furthermore, it is well known that parallel importation of true products has been carried out for a considerable number of years in Japan on a broad variety of products. However, after closely studying all the evidence presented in this case, the Court fails to find any evidence which shows the fact that such parallel importation has impeded the introduction of licensed technology. [BBS'] arguments on this point relies [sic] on abstract statements without factual substantiation, and thus are not taken.[38]

C. The Decision's Effects

The Tokyo High Court's decision in *Japanese-Auto Products* departs from long-standing patent customs in most countries, including the United States and Japan.[39] The first-sale doctrine generally limits domestic patent protection.[40] Essentially, the first-sale doctrine allows a patent holder to collect a royalty for the first sale of a patented item, but not for subsequent sales to third parties.[41]

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37. *See id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 16 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

38. *Id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 16-17 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

39. *See* Riordan, *supra* note 3.

40. *See* Hahn, *supra* note 16. This doctrine is analogous to the "exhaustion" doctrine mentioned in the Tokyo High Court's opinion.

41. Riordan, *supra* note 3.

Thus, if the new owner decides to sell the item to a third party, the original patent holder does not collect a second royalty.[42] The first-sale doctrine traditionally applies, however, only to products resold within the borders of the country granting the patent, thus preventing companies from buying patented products in a country where they are sold at minimal cost and reselling them in another country with a similar patent for a higher price.[43] The Tokyo High Court's application of the first-sale or exhaustion doctrine to an international sales transaction significantly deviates from settled law.[44]

Another patent law concept intricately involved with the decision is the "parallel importation" of "gray market"[45] goods. Under the *Japanese-Auto Products* facts, BBS' wheels constitute the gray market goods, and Japanese-Auto's importation of the goods is the act of parallel importation. Prior to this decision, neither the United States nor Japan permitted parallel importation of patented products.[46] Nevertheless, the court's ruling seems to permit the importation of gray market goods for sale to Japanese consumers with no royalties reverting to the original patent holder.[47]

This ruling is good news for Japanese consumers who ultimately pay less for brand-name goods.[48] On the other hand, *Japanese-Auto Products* would jeopardize reasonable profits for U.S. companies holding domestic and Japanese patent rights.[49] If the ruling stands, a company may buy patented goods in the United States and resell them freely in Japan, irrespective of the patent holder's rights in both countries.[50] The strength of the yen and the high desirability of U.S. goods provide incentive for competitors to circumvent Japanese patents that U.S. companies obtain and to

42. *See id.*

43. *See id.*

44. *See* Hahn, *supra* note 16.

45. The term "gray market" has been used to indicate the doubtful legality of parallel importation, which lies on the "fringes of legality." *See* Osawa & Co. v. B & H Photo, 589 F. Supp. 1163, 1170 (S.D.N.Y. 1984). This fringe lies somewhere between legally free competition and an illegal "black market."

46. *See* Slind-Flor, *supra* note 14.

47. *See id.*

48. *See* Riordan, *supra* note 3.

49. *See* Hahn, *supra* note 16.

50. *See id.*

import inexpensively produced U.S. goods into Japan.[51] Consequently, this ruling lends further credence to the argument that Japan discriminates against foreign businesses, especially from the United States.[52] Such discrimination may spark new tension in the already simmering U.S.-Japanese trade relationship.

III. PARALLEL IMPORTATION

A. Parallel Importation in the United States

1. Trademarked Goods

For purposes of trademark law, "parallel imports" or "gray market"[53] goods are genuine, mass-merchandised consumer products with a brand name that a trademark or copyright protects.[54] Domestic suppliers usually sell or license to sell these goods under sales contracts or licensing agreements that restrict their sale to different global markets, often overseas.[55] Parallel importation occurs when gray market "pirates" import these goods back to the country of origin for resale, generally against the wishes of domestic suppliers.[56]

In the United States, domestic suppliers of trademarked goods attack the lack of protection against parallel importation.[57] Similar to the free market disdain against alienation relating to the first-sale doctrine, free market proponents favor "the parallel im-

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51. *See* Riordan, *supra* note 3.

52. *See* Hahn, *supra* note 16.

53. This Note uses the term "gray market" goods as opposed to "parallel imports" to refer to products discernible from the concept of parallel importation.

54. *See* Steven L. Hock & Robert A. Weikert, *Gray Market Goods, Counterfeit Goods and the Antitrust Laws, in* THE LAW OF GRAY AND COUNTERFEIT GOODS 437, 439 (PLI Patents, Copyrights, Trademarks, & Literary Property Course Handbook Series No. 236, 1987). Gray market goods are distinguishable from counterfeit goods. *Id.* Counterfeit goods intentionally imitate a product's trademark, whereas gray market goods have the manufacturer's genuine trademark. *Id.*

55. *See, e.g.*, J. Joseph Bainton & Kathleen Janetatos Smith, *Gray Goods: A Real Problem with a Genuine Solution*, in THE LAW OF GRAY AND COUNTERFEIT GOODS, supra note 54, at 301, 303-04.

56. *Id.*; *see, e.g.*, Sebastian Int'l, Inc. v. Consumer Contact Ltd., 664 F. Supp. 909 (D.N.J. 1987), *vacated*, 847 F.2d 1093 (3d Cir. 1987).

57. *See* Doris R. Perl, Comment, *The Use of Copyright Law to Block the Importation of Gray-Market Goods: The Black and White of It All*, 23 LOY. L.A. L. REV. 645, 646-47 (1990).

porter's efforts to offer consumers the option of purchasing [goods] at competitively lower prices."[58] "The unauthorized importers have maintained that because their activity encourages price competition and benefits the consumer, it should be freely permitted."[59] The importers believe that preventing this competition "would be inconsistent with the interests of consumers."[60]

Gray market goods may, however, cause problems that outweigh the benefits to consumers. First, consumers "may be deprived of warranty and products liability protection and may receive inferior goods."[61] Second, consumer expectations may be frustrated because the buyer is likely to believe that U.S. trademark laws protect the purchased product.[62] Finally, the parallel importer enjoys a "free ride on the sales and promotional efforts of the trademark owner."[63]

Gray market goods substantially affect the domestic marketplace[64] because the parallel importation of such goods has developed into a multi-billion dollar industry in the United States.[65] Consequently, U.S. suppliers are losing profits and the chance to cultivate foreign markets.[66] U.S. manufacturers who wish to sell their products in foreign markets may utilize exclusive distributors

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58. *Id.*

59. TIMOTHY H. HIEBERT, PARALLEL IMPORTATION IN U.S. TRADEMARK LAW 1 (Contributions in Legal Studies No. 74, Paul L. Murphy ed., 1994).

60. *Id.*

61. Joseph M. Fitzpatrick & William J. Brunet, *Barring Importation of Gray Goods Under Section 42 of the Lanham Act, and Section 526 of the Tariff Act, in* GRAY MARKETS AND PARALLEL IMPORTATION 9, 11 (PLI Patents, Copyrights, Trademarks, & Literary Property Course Handbook Series No. 217, 1986). The court rejected this argument. Interestingly, the court acknowledged the significance of this safety issue: "[t]he parallel importer rarely bothers to have information on the customers who have been sold the wheels, and there should be a serious possibility that such a crude quality control (in their business) may lead to unexpected loss and damages on the part of the customers (users)." Japanese-Auto Products, 1524 HANREI JIHŌ 3, *translated in* Judgment to the Case of NE No. 3272/1994, at 5 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*); *see also* Richard B. Kelly, *An Overview of the Influx of Grey Market Goods into the United States*, 11 N.C. J. INT'L L. & COM. REG. 231 (1986) (providing an in-depth analysis of the relationship between gray market goods and specific trademark statutes).

62. *See* Fitzpatrick & Brunet, *supra* note 61, at 11.

63. *See id.* at 12.

64. *See* Perl, *supra* note 57, at 678.

65. *See id.* at 646.

66. *See id.* at 678.

who import the product from the manufacturer, sell the product in their countries and build goodwill in the foreign markets through advertising.[67] A third party - the parallel importer - however, may purchase identical products from distributors in other countries and import those products in direct competition with the exclusive local distributor.[68] Thus, the parallel importer avoids local advertising costs[69] and sells the product below the authorized distributor's prices.[70]

2. Patented Goods

For the purposes of patent law, gray market imports are products that are legally produced or sold under a patent in another country, purchased in a foreign market, and imported for sale back to the United States without the U.S. patent owner's authorization.[71] In the United States, the general rule is that a patent "grants to the patent holder the right for [twenty] years to exclude others from making, using, or selling the patented invention within the United States."[72]

B. Parallel Importation in Japan

1. Trademarked Goods

The parallel importation of "genuine goods" has been protected in Japan since the Osaka District Court's decision in *N.M.C. K.K. v. Shriro Trading*[73] (the Parker Pen case). In the Parker Pen case, plaintiff N.M.C. purchased fifty dozen "genuine" Parker pens from a Hong Kong company and filed a petition to import the

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67. *See* HIEBERT, *supra* note 59, at 1.

68. *See id.*

69. *See id.*

70. *See id.*; *see also* Stuart Auerbach, *The Gray Market: Where a $200 Watch Can Be Bought for $140*, WASH. POST, Dec. 16, 1984, at L1.

71. *See* David Bender & Daniel Gogek, *Gray Market Goods: Substantive Law, in* THE LAW OF GRAY AND COUNTERFEIT GOODS 43, *supra* note 54, at 97-98.

72. *Id.* at 98; *see also* 35 U.S.C. § 271 (1984), which states in pertinent part:

> (a) Except as otherwise provided in this title, whoever without authority makes, uses or sells any patented invention, within the United States during the term of the patent therefore, infringes the patent.
>
> (b) Whoever actively induces infringement of a patent shall be liable as an infringer.

73. 2 MUTAI SAISHU 71, (Osaka Dist. Ct., Feb. 27, 1970).

pens into Japan even though defendant Shriro Trading (Shriro) had an exclusive distributorship and an exclusive use right.[74] The Osaka Customs Office told N.M.C. that it could not issue an import permit even though Shriro had previously consented because Shriro had not done so in writing.[75] N.M.C. brought suit, arguing that Shriro had no right to exclude importation of genuine Parker pens.[76] The court held that although Shriro had an exclusive right, it could not enjoin the importation or sale of pens manufactured in the United States bearing the Parker Pen company's mark.[77] The court reasoned:

> The purpose of giving the trademark owner a right of exclusive use of the registered trademark . . . is to protect the indication of source as well as to guarantee the quality from being harmed by the use of an identical or similar trademark on identical or similar goods by a third person . . . . The law purports to maintain orderly distribution of goods and protects the interest of the consuming public by enabling them to identify the goods that they choose to buy and to obtain goods of the quality they desire . . . . Therefore, the scope of the territoriality principle of trademarks must be determined in the light of the purpose of trademark protection, and infringement must be determined by judging whether or not the proper functions of the trademark are harmed.[78]

The court limited its opinion to situations where goods of the same quality were distributed in the world market bearing the same trademark.[79]

This holding influenced tremendously the Japanese government's decision to remove restrictions on parallel importation of genuine goods.[80] For the past twenty-five years, court decisions

74. *See* TERUO DOI, INTELLECTUAL PROPERTY PROTECTION AND MANAGEMENT: LAW AND PRACTICE IN JAPAN 276-77 (Comparative Law Study Series No. 19, 1992).

75. *See id* at 277.

76. *See id.*

77. *See id.*

78. *Id.* at 277-78.

79. *See id.* at 279.

80. *See id.* at 280.

The Tokyo High Court explained the proliferation of parallel importation as follows:

> In spite of having purchasing power for higher than the above-average level, because of Japan's market being inclined to be closed to outsiders, the differences in compared prices are rather conspicuous; therefore, "parallel importation" of patent products is being widely practiced. Take, for example, automobiles,

have affirmed, with little variation, the *N.M.C.* holding, which allowed parallel importation of trademarked goods.[81]

2. Patented Goods

Until *Japanese-Auto Products,* Japanese courts had infrequently dealt with the issue of parallel importation of patented goods. Author Teruo Doi stated the issue as follows:

> In a case where the owner of a Japanese patent owns the corresponding patent in a foreign country, a question may arise as to whether an unauthorized importation of the products that were lawfully manufactured by the owner or by his licensee in that foreign country infringes his Japanese patent.[82]

The *Japanese-Auto* court faced the identical situation. A lack of precedent regarding parallel importation of patent goods left much discretion to the *Japanese-Auto* court. Only one prior court decision, *Brunswick Corp. v. Orion Kogyo K.K.,*[83] addressed this specific issue.[84]

In *Brunswick Corp.,* plaintiff Brunswick Corp. (Brunswick), owned patents in several countries, including Japan, for an automatic pinsetting device for bowling machines.[85] Brunswick's Venezuelan subsidiary, BIAC, sublicensed its Australian patent to Blackrock Company of Australia.[86] Defendant Orion Kogyo (Orion), who operated a bowling alley in Osaka, imported several bowling machines with the patented mechanisms.[87]

Orion, like Japanese-Auto, argued that Brunswick's sublicen-

> which are a virtual concentration of patents. Among approximately 200,000 automobiles imported in a year, about 10 percent are of parallel importation.

Japanese-Auto Products, 1524 HANREI JIHŌ 3, *translated in* Judgment to the Case of NE No. 3272/1994, at 4 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

81. *See id., translated in* Judgment to the Case of NE No. 3272/1994, at 4 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*); *see also* Heiwado K.K. v. K.K. Kinseido, 10 MUTAI SAISHU 216 (Tokyo Dist. Ct., May 31, 1978); La Chemise LaCoste S.A. v. Shinshin Boeki K.K., 1141 HANREI JIHŌ 143 (Tokyo Dist. Ct., Dec. 7, 1984).

82. DOI, *supra* note 74, at 290.

83. 1 MUTAI SAISHŪ 160 (Osaka Dist. Ct., June 9, 1969).

84. *See* DOI, *supra* note 74, at 290.

85. *See id.*

86. *See id.*

87. *See id.*

see in Australia had exhausted Brunswick's patent right upon the sale of the device, and thus, Brunswick could no longer sue for patent infringement against purchasers of its product.[88] Orion additionally argued that the territoriality principle of patent protection[89] should not extend to Brunswick's patent because trademark protection is not based on the territoriality principle.[90] The court denounced this argument in favor of a strict territoriality principle of patent protection:

> With respect to trademarks, conflicting views have been expressed in European countries in connection with the application of the territoriality principle on the question of whether or not importation of genuine trademarked goods constitutes an infringement of the domestic trademark right concerned. Many of the arguments which deny infringement point out the purpose of the trademark system lies in the protection of consuming public through the function of trademarks to distinguish products, and, from this starting point, they conclude that the territoriality principle of trademarks should stay one step back before international free trade in the age of integration of domestic markets of various countries. It is not right to apply this theory to patents which have an entirely different purpose and nature from trademarks.[91]

Thus, the court held that Brunswick's Australian patent was exhausted, but its corresponding Japanese patent was not affected.[92]

The difference between *Japanese-Auto* and *Brunswick Corp.* is that in *Brunswick Corp.*, a licensee of Brunswick manufactured the bowling mechanism, whereas in *Japanese-Auto*, BBS, not a licensee, manufactured the wheels. This slight factual difference should not justify a different outcome. Nevertheless, the *Japanese-Auto* court, departed from the *Brunswick* court's ruling on parallel

88. *See id.* at 290-91.

89. "[T]he territoriality theory posits trademark rights in a particular region and in the goodwill created by the owner in the regional sale of the product. A trademark could have separate legal existence in each country under the laws of that country." Shubha Ghosh, *An Economic Analysis of the Common Control Exception to Gray Market Exclusion*, 15 U. PA. J. INT'L BUS. L. 373, 385 (1994) (footnote omitted); *see also* SETH E. LIPNER, THE LEGAL AND ECONOMIC ASPECTS OF GRAY MARKET GOODS 14 (1990) (discussing the history of the territoriality theory).

90. *See* DOI, *supra* note 74, at 291.

91. *Id.*

92. *See id.*

importation of patent goods. The court's ruling against BBS departs from the territoriality principle, previously thought to be settled international patent law.[93]

Like Brunswick, BBS disputed Japanese-Auto's argument as violating the principles of patent independence[94] and territorial jurisdiction under articles 2 and 4-bis of the Paris Convention for the Protection of Intellectual Property (Paris Convention).[95] Courts

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93. In 1930, Stephen P. Ladas was "the first [person] to endow the [principle of territoriality] with its modern meaning." HIEBERT, *supra* note 59, at 144 n. 13. Ladas wrote:

> In the Anglo-American world the territorial conception of law and rights includes the industrial property, namely, these legalized private interests in incorporeal things .... But the same principle of territoriality is also admitted in the other countries in regard to rights of industrial property. That is, when the law turns a private interest in an invention or a goodwill into property, this property is a mere creature of that law, and it can therefore exist only so far as the law that creates it extends. Consequently, a patent granted in country A cannot extend outside the territory of that country. And similarly, a trademark right acquired in one country is effective only in the country where it was acquired.

STEPHEN P. LADAS, THE INTERNATIONAL PROTECTION OF INDUSTRIAL PROPERTY 17 (1930) (footnote omitted). Fritz Ostertag categorized the principle of territoriality as a choice-of-law rule:

> The first rule concerning the applicability of law is as follows: the court of the country where protection of industrial property is claimed shall apply the domestic law (lex fori) (principle of territoriality) .... Suppose that a trademark, registered in the United States, is registered in Switzerland as well. The legal form of the mark and all conditions of its existence are judged according to American law.

FRITZ OSTERTAG, *International Unions for the Protection of Industrial, Literary and Artistic Property*, 25 MICH. L. REV. 107, 109-10 (1926).

94. Article 4-bis of the Paris Convention espoused the patent independence principle.

> [T]he establishment of a patent right, its effects and expiration . . . are independent within each country; i.e., any changes with a patent in another country shall not influence the patent in your own country. Therefore, if one believes that where a patent right in Country "A" [e.g. Germany] is exhausted by the due distribution (sales) of the patent product in the country, the patent right in country "B" [e.g. Japan] having the same contents as in country "A" and owned by the same person shall obviously been [sic] exhausted, such consideration should clearly stand against the principles [sic] of Patent Independence.

Japanese-Auto Products, 1524 HANREI JIHŌ 3, *translated in* Judgment to the Case of NE No. 3272/1994, at 7 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

95. *See* Paris Convention for the Protection of Industrial Property, Mar. 20, 1883, 25 Stat. 1372. *See, e.g.*, Osawa & Co. v. B & H Photo, 589 F. Supp. 1163, 1172 (S.D.N.Y. 1984); *In re* Certain Alkaline Batteries, 225 U.S.P.Q. (BNA) 823, 828 (Int'l Trade Comm. 1984); Weil Ceramics & Glass, Inc. v. Dash, 618 F. Supp. 700, 705 n.1 (D.N.J. 1985).

often cite the Paris Convention to justify the territoriality theory.[96] Prior to 1883, trademark laws of many countries tended to discriminate against foreign trademark owners who wished to register their trademarks in those countries.[97] Each nation "made it difficult for foreigners to enjoy domestic trademark protection."[98] Some countries entered into commercial treaties containing "reciprocal treatment" provisions.[99] These agreements granted rights and privileges to each trademark holder in the jurisdiction of the other nation.[100] Depending on the presence of bilateral treaty protection and its particular terms of protection, some trademark holders still enjoyed more favored status than others.[101] In response to these problems, the Paris Convention established the Union for the Protection of Industrial Property.[102] Each member country agreed to accord to citizens of other countries the same trademark rights that it granted to its own citizens.[103]

IV. FIRST-SALE DOCTRINE

The first-sale doctrine potentially establishes a compelling defense to the gray market importer.[104] The U.S. Supreme Court first introduced the first-sale doctrine in *Bobbs-Merrill Co. v. Straus*.[105] The doctrine developed over time, and Congress eventually codified it in 17 U.S.C. § 109(a),[106] which reflected Congress' apparent agreement with the traditional free market notion against re-

96. HIEBERT, *supra* note 59, at 134.
97. *See id.*
98. *Id.*
99. *See id.*
100. *See id.*
101. *See id.*
102. *See id.* at 134-35.
103. *See id.* at 135.
104. *See* Bender & Gogek, *supra* note 71, at 91.
105. 210 U.S. 339, 350-51 (1908).
106. *See* 17 U.S.C. § 109(a), which provides in pertinent part:

> Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.

Interestingly, this provision says nothing about whether an actual "sale" has to occur; the language only pertains to ownership.

straints on alienation.[107] Because 17 U.S.C. § 109(a) pertains to copyright infringement, it does not yield an absolute defense to patent infringement claims in domestic cases by protecting the resale of the product.[108] Nevertheless, this section sheds light on the first-sale doctrine and its significance to the *Japanese-Auto* case.[109]

In *BMG Music v. Perez*,[110] the Ninth Circuit explicitly stated that the first-sale doctrine applies to foreign copyright infringement cases only when the "first sale" is made in the United States.[111] In *BMG Music*, defendant, Edmundo Perez purchased copyrighted sound recordings manufactured abroad, imported them into the United States, and sold them in retail outlets.[112] The court pointed out that "[t]he first sale doctrine in 17 U.S.C. § 109(a) does not . . . provide a defense to infringement under 17 U.S.C. § 602[113] for goods manufactured abroad."[114] The Ninth Circuit stated: "the words 'lawfully made under this title' in section 109(a) grant first sale protection only to copies legally made and sold in the U.S."[115]

Cases involving the interplay between section 17 U.S.C. § 109(a) and 17 U.S.C. § 602 often arise where goods are both manu-

107. *See* Perl, *supra* note 57, at 651.

108. *See id.* Yet, gray market plaintiffs have increasingly turned to copyright law and § 109(a) for protection. Ghosh, *supra* note 89, at 397. The problem with this idea, however, is "the possibility of copyright law enveloping the domain of trademark law." *Id.* Arguably, if copyright law is applied to trademark areas like labels and product names, trademark law could be avoided totally. *See id.* For an argument that extending copyright law to the gray market area is not as adverse to copyright policy as one might think, see Donna K. Hintz, Comment, *Battling Gray Market Goods with Copyright Law*, 57 ALB. L. REV. 1187 (1994).

109. "Unlike trademark statutes and regulations which have been extensively and decisively analyzed, the copyright provisions invoked by suppliers and gray market importers have not undergone intensive judicial scrutiny. In fact, few appellate courts have yet commented on the problem in any detail." Perl, *supra* note 57, at 651 (footnote omitted).

110. BMG Music v. Perez, 952 F.2d 318 (9th Cir. 1991).

111. *Id.* at 319. This concept was affirmed in *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, 38 F.3d 477, 481 (9th Cir. 1994).

112. *BMG Music*, 952 F.2d at 319.

113. *See* 17 U.S.C. § 602(a) (1994), which states: "[i]mportation into the United States, without the authority of the owner of copyright under this title . . . of a work that [has] been acquired outside the United States is an infringement of the exclusive right to distribute copies . . . under section 106."

114. *BMG Music*, 952 F.2d at 319.

115. *Id.*; *see also* CBS, Inc. v. Scorpio Music Distrib., Inc., 569 F. Supp. 47 (E.D. Pa. 1983), *aff'd mem.*, 738 F.2d 424 (3d Cir. 1984).

factured and first sold abroad.[116] These decisions have held that the party entitled to a first-sale royalty could block the importation of the goods under 17 U.S.C. § 602 and have denied importers a defense under 17 U.S.C. § 109(a).[117] In effect, 17 U.S.C. § 602 preempts any defenses available under 17 U.S.C. § 109(a).

The first major case to focus on the interplay between these two statutes was *CBS v. Scorpio Music Distributors, Inc.*[118] *CBS*, like *Japanese-Auto*, involved goods that were manufactured and first sold abroad. The defendant distributor of phonorecords used 17 U.S.C. § 109(a) as its defense.[119] It argued that because an authorized first sale abroad was the source of the records that it had purchased for sale in the United States, CBS' rights were exhausted after the first sale.[120] The court refused to allow 17 U.S.C. § 109 to supersede 17 U.S.C. § 602, concluding that the first-sale defense under 17 U.S.C. § 109(a) did not extend overseas.[121]

The Tokyo High Court's ruling in *Japanese-Auto* could be viewed as inconsistent with the principles behind 17 U.S.C. § 602, and thus, a departure from patent law principles in the United States and the international trade arena.[122] The court focused its attention on articles 2 and 4-bis of the Paris Convention.[123] "[I]t is clear that the Japanese Patent Law limits its application and validity to territorial Japan, i.e., Japan also adopts the Principle of Territorial Jurisdiction."[124] BBS argued, however, that if exhaustion of patent rights on a product in a foreign country exhausted patent rights on the same product in one's home country, then the patent rights would be internationally exhausted, which would violate the

116. *See* Perl, *supra* note 57, at 651; *see also* Hearst Corp. v. Stark, 639 F. Supp. 970 (N.D. Cal. 1986).

117. *See* Perl, *supra* note 57, at 651-52.

118. 569 F. Supp. 47 (E.D. Pa. 1983), *aff'd mem.*, 738 F.2d 424 (3d Cir. 1984).

119. *See* Bender & Gogek, *supra* note 71, at 92.

120. *See id.*

121. *See id.*

122. *See* Hahn, *supra* note 16.

123. *See Japanese-Auto Products*, 1524 HANREI JIHŌ 3, *translated in* Judgment to the Case of NE No. 3272/1994, at 7 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

124. *Id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 7 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

principles of patent independence and territorial jurisdiction.[125]

The Tokyo High Court considered BBS' international exhaustion theory, but ultimately rejected it.[126] "[U]nder the Principles of Patent Independence and Territorial Jurisdiction, the validity of the patent right established by Japan's Patent Law should be interpreted by *Japan's* interpretation of the Japanese Patent Law."[127] Thus, whether the court may take into account the sale or distribution of the patented product in a foreign country is a matter of interpretation of Japan's patent law, not of the Paris Convention's by-laws.[128]

The court rejected both BBS' territoriality and past precedent arguments regarding patent protection in the international arena. This ruling ostensibly benefits Japanese consumers, who often pay higher prices for identical goods sold for significantly less in other countries.[129] It may, however, also preclude patent-holders in foreign countries from getting a fair price for their products in Japan.[130]

V. CURRENT TENSION IN U.S.-JAPANESE TRADE RELATIONS AND THE EFFECTS OF THE *JAPANESE-AUTO* DECISION

A. Background on U.S.-Japanese Trade Relations

Westerners, particularly U.S. residents, believe that a horrible economic slump in the 1990s damaged Japan, however, the evidence, does not support this conclusion.[131] For example, the yen

125. *See id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 7-8 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

126. *See id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 7-8 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

127. *Id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 8 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

128. *See id.*, *translated in* Judgment to the Case of NE No. 3272/1994, at 8 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

129. Riordan, *supra* note 3.

130. *See* Slind-Flor, *supra* note 14.

131. *See* Eamonn Fingleton, *Japan's Invisible Leviathan*, FOREIGN AFF., Mar./Apr. 1995, at 69.

continues to remain very strong, having risen nearly forty percent against the U.S. dollar over the past five years.[132] In 1994, the U.S. trade deficit with Japan climbed to $62 billion—an all-time high.[133] Additionally, growth in Japan's exports created an unprecedented trade surplus of $127 billion.[134] Thus, Japan is clearly not an economic "has been." Perhaps when Westerners experienced an economic slump in their own land, they naturally thought that it hit Japan with the same force.[135]

While the Western press talks of economic collapse, Japan remains on schedule to surge past the United States and become the world's largest economy by the millennium.[136] The United States figured to share in this Japanese surge. For example, in the 1980s, Prime Minister Nakasone led President Ronald Reagan to believe that the Japanese government was ready to undergo a period of "internal demand stimulation" to encourage U.S. imports and reduce Japanese exports.[137] This never happened.

"This peculiar dynamic of imminent turning points that seem always to recede before they can be realized has become characteristic of U.S.-Japan trade relations."[138] Thus, each side tends to react with criticism to the other side's good faith.[139] Japanese society denounces U.S. products as poorly designed and weakly marketed.[140] In contrast, U.S. society attacks Japanese industrial and social policies as protectionist and criticizes Japanese fiscal policy as too restrictive.[141] As a result, the trade relationship between Ja-

132. *See id.*

133. *See* Martin Crustinger, *Japan, U.S. Play Down Pre-Summit Frictions*, ORANGE COUNTY REG., Jan. 10, 1995, at C03, *available in* 1995 WL 5826842. The latest numbers recorded in November 1995, however, are encouraging, as they show that the U.S. trade deficit with Japan declined for the fifth consecutive month. James Gerstenzang, *U.S. Trade Deficit Hits Lowest Level in Two Years*, L.A. TIMES, Feb. 8, 1996, at D1.

134. *See* Fingleton, *supra* note 131, at 69.

135. It cannot be said, however, that Japan's financial markets have not undergone a scare within the past ten years. For example, the Tokyo stock market dropped 63% in the early 1990s. *See id.* at 70.

136. *See id.* at 69.

137. *See* Daniel K. Tarullo, *Foreword: The Structure of U.S.-Japan Trade Relations*, 27 HARV. INT'L L.J. 343 (1986).

138. *Id.* at 344.

139. *See id.*

140. *See id.*

141. *See id.*

pan and the United States has remained quite strained. The U.S. mistrust of Japan's intentions and vice versa has hindered any advancement in the countries' trade relations. As the two countries vie for economic supremacy, a tense trade atmosphere, has inevitably developed and burgeoned.

B. Limited Access to the Japanese Market

U.S. residents find it difficult to ignore the substantial economic imbalance between Japan and the world market. At the forefront of this imbalance are Japan's unique market access barriers.[142] "They stem from the complex interaction of Japan's economic structure, private business organizations and practices, relations between the Japanese private sector, and government, and government policies and regulatory practices."[143] The Japanese system appears impenetrable because, unlike tariffs, these barriers are not traditional barriers to trade.

Unpredictable economic regulations add to this problem.[144] Japanese legislators often write economic laws in general rather than specific terms, and administrative officials supply the details.[145] The broad discretion of government officials makes it nearly impossible for foreign businesses to learn Japanese business requirements.[146]

Furthermore, business practices between producers and suppliers, distributors and producers, and other companies within an industry group also hinder market access for foreign entrants.[147] These practices prevent foreign businesses from gaining customers on the basis of factors such as price, quality, and service.[148] Further, Japan's anti-monopoly laws are largely ineffective; numerous exceptions, lax enforcement, and inadequate penalties plague them.[149]

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142. *See* Charlene Barshefsky, *The Future of U.S.-Japan Tradé Relations*, 25 L. & POL'Y INT'L BUS. 1287, 1292 (1994).

143. *Id.*

144. *See id.* at 1293.

145. *See id.*

146. *See id.*

147. *See id.*

148. *See id.*

149. *See id.*

Finally, Japan's outdated and expensive distribution system continues to block foreign firms from gaining access to the Japanese market.[150] Foreign businesses find it difficult and costly to enter existing distribution channels, much less to formulate their own channels.[151]

Consequently, Japan's domestic markets are clearly less open to foreign competition than other countries' markets.[152] Despite years of "market-opening" efforts, critics of Japanese policy remain on the offensive regarding easing access to Japanese consumers.[153] A total opening of the Japanese market would result in a huge expansion of U.S. exports from $9 to $18 billion annually, which would lead to the creation of 180,000 to 360,000 jobs in the United States alone.[154]

Critics argue that U.S. businesses are not the only losers in a restricted market. The burden of Japan's closed market and subsequent inflated prices for goods falls "most heavily on its own people."[155] Hence, Japanese consumers have become restless with their government for "coddling" Japanese companies.[156] The prospect of a new market with eager buyers willing to purchase U.S. goods led the Clinton Administration to pursue a bilateral trade

150. *See id.*

151. *See id.*

152. *See id.* at 1287.

153. *See id.* at 1287-88.

154. *See id.*

155. *See id.* Japanese businesses, as well as consumers, suffer as a result of limited access. "Limited market access in Japan fosters inefficiencies that slow economic growth and today hamper the competitiveness and productivity of Japanese business. Japan's policies therefore burden not only Japanese consumers, but the Japanese economy overall, and with it, the world economy." *Id.*

156. Editorial, *Now, Ante Up*, ASIAN WALL ST. J., June 30, 1995, at 8. With the new trade pact, Japan's strict trade policy and its concomitant burden on Japanese consumers became readily apparent.

> As new discount houses spring up to sell cheap foreign merchandise, Japan's once unassailable distribution cartels are coming under heavy pressure. They are being forced to cut prices and, because of protections they have enjoyed, they have plenty of room to cut. This indicates that the cartels and domestic manufacturers have indeed been gouging consumers. Government protections for this derive from Japan's long-standing policy of using its domestic market base as a springboard for its export industries, a policy that demands strong profits in the home market.

Id.

pact with Japan. The pact's paramount goal was to open Japan's markets.[157]

C. The 1995 Trade Pact

After two years of negotiations, the United States and Japan finally reached a trade agreement in June 1995.[158] The agreement came after President Clinton's threat to level one hundred percent tariffs on several Japanese car models.[159] Although the accord, which U.S. officials have praised, has averted a trade war between the two countries, it does not appear to be a complete victory for the United States.[160] While U.S. auto parts manufacturers benefited from Japan's pledge to purchase $9 billion in U.S. made auto parts, Japanese car plants operating in the United States will purchase more than two-thirds of the parts.[161] Additionally, the trade agreement may not deserve full credit for Japan's pledge because Japanese car makers set their sights on producing cars in the United States several years earlier.[162] Essentially, the trade pact compelled Japan's major automakers to set U.S. expansion goals down on paper, but did not fully commit to opening the Japanese market to all Western industries.[163] Imports to major economic sectors in Japan, such as telecommunications, medical equipment, and insurance, are still subject to limits.[164]

More U.S. cars will end up in the Japanese market due to the trade agreement.[165] Although the auto industry seems to be the only foreign industry that Japan is willing to allow, this appears to satisfy the goal of access to the once restricted Japanese market. As a result of this trade pact, U.S. relations with Japan seem to be

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157. *See* Barshefsky, *supra* note 142, at 1289.

158. *See U.S., Japan Both Claim Victory*, *supra* note 1.

159. *See id.*

160. *See* Editorial, *Who Won? Trade War Armistice*, ARIZ. REPUBLIC, June 30, 1995, at B4, *available in* 1995 WL 2806674.

161. *See id.*

162. *See id.*

163. *See id.*

164. *See* Barshefsky, *supra* note 142, at 1290-91.

165. In February 1996, U.S. Trade Representative Mickey Kantor said: "Our exports to Japan are increasing at a rate four times our imports." Gerstenzang, *supra* note 133, at D1. Additionally, Kantor said exports of American cars and automobile parts to Japan had climbed 36% during 1995. At the same time, Japanese auto exports declined by 5%. *See id.*

on the upswing. The *Japanese-Auto* decision may, however, end these new found hopes and trigger another trade crisis.

D. The Effects of the Japanese-Auto Decision *on U.S.-Japanese Trade Relations*

On the average, prices for goods in Japan are thirty-seven percent higher than in the United States.[166] Thus, the *Japanese-Auto* decision may encourage an increase in the parallel importation of U.S. goods into Japan. Because of these higher prices, U.S. intellectual property holders will argue that they should receive the Japanese market's potential benefits—notably higher prices and higher profits. If *Japanese-Auto* is affirmed, however, "a company could buy patented goods in a foreign country and resell the goods in Japan, despite the patent holder's rights in both countries. The patent holder's marketing efforts in Japan would always be subject to an importer's ability to undersell the patent holder."[167]

The *Japanese-Auto* ruling quickly prompted peace-making missions from Japan to both Germany and the United States.[168] Intellectual property experts from Japan and the United States met only weeks after the decision.[169] The peace-making missions may indicate that Japan's intellectual property leaders believe that the *Japanese-Auto* decision cannot stand and is consistent with past Japanese discrimination of foreign businesses. On the other hand, the missions may simply be government "damage control," to make it appear that government and patent officials are denouncing the ruling, even though they are happy with it.

VI. PRACTICAL CONSIDERATIONS OF THE JAPANESE-AUTO DECISION

A. Can This Decision Actually Hurt Japan?

The *Japanese-Auto* decision may hurt Japanese businesses. A few critics of the decision have addressed the situation where goods are made in Japan, imported and sold in the United States, and then parallel imported by a foreign company to Japan, thereby

166. *See* Barshefsky, *supra* note 142, at 1292.
167. Hahn, *supra* note 16.
168. *See* Slind-Flor, *supra* note 14.
169. *See id.*

circumventing the Japanese patent holder's right to a second profit. For example, suppose Japanese- manufactured wheels sold in the United States were resold in Japan by a U.S. business. Pursuant to the *Japanese-Auto* decision, the foreign-owned U.S. business rightfully profits upon the sale in Japan.

Because of the loosening of access to Japan's market and exorbitant prices, particularly in the auto parts sector, this type of situation is increasingly likely to occur as the year 2000 approaches. Thus, Japan's own businesses could be on the short end of this decision. If the impetus behind the court's ruling is to protect Japanese businesses, then the decision against BBS may backfire.

B. Why Should Intellectual Property Holders Profit a Second Time Anyway?

Another aspect of the *Japanese-Auto* decision is that its harshest critics favor allowing intellectual property holders to profit, regardless of the situation. Critics argue, that the disparity in prices between markets like the United States and Japan should enable the patent holder to capitalize on the higher prices; the owner of the trademark or patent is entitled to the profits from any sale in another country.

Such profits, however, are merely windfall profits, and nothing in international intellectual property law mandates windfall profits. For example, BBS already profited from the first sale in Germany. Thus, there is no reason that it should profit again just because the resale occurred in another country. Enabling BBS to profit from the higher prices in Japan only creates windfall profits. If intellectual property holders are not entitled to these so-called windfall profits, then the *Japanese-Auto* ruling is consistent with this ideal.

C. Should Intellectual Property Rules Be Applied Internationally?

A solution to the problem may be to recognize the dominant influence of the international market and apply intellectual property rules internationally rather than territorially. If the first-sale doctrine applies in the United States, why should it not apply internationally as well? Also, if the U.S. purports to be an avid proponent of free markets, then it should support the Japanese-Auto corporation acting in its best interests by capitalizing on the second sale of the wheels. By criticizing the *Japanese-Auto* decision, U.S. officials appear determined to have the law work both ways in favor of U.S. businesses.[170]

The *Japanese-Auto* court addressed the issue of applying rules internationally in the end of its opinion:

> Again furthermore, the matter of allowing, or not allowing, parallel importation of patent products differs legally from one country to another, or even one region to another, and are [sic] not consistent over the world; also, there are many attempts to reach and enter into international agreements or treaties in the field of intellectual property including patent rights. [This] Court is quite aware of these conspicuous facts. Now, the position of the many countries with respect to economic status vary over a wide range depending on their historical, economical and technical background, and their legal disposition towards parallel importation are certainly not consistently [sic]. However, given that international agreements are not established with respect to parallel importation, such should not influence the interpretation of the Japanese Patent Law that parallel importation of true products should not constitute infringement of the patent right.[171]

Thus, the court seemed pessimistic about the viability of a coherent international rule on intellectual property encompassing all countries. In other words, BBS should not be entitled to profit because its patent was exhausted once its wheels were sold in Germany.

VII. CONCLUSION

BBS has appealed the Tokyo High Court's ruling. If the ruling is affirmed, the United States may seek to have it modified in some way.[172] An enormous U.S. outcry that could threaten significant gains in U.S.-Japanese trade may lead the Japanese gov-

170. Additional U.S. arguments such as protecting domestic employment, industrial protection, and balance of trade arguments may be irrelevant because parallel importation usually does not involve U.S. manufacturing jobs. *See* Kelly, *supra* note 61, at 243.

171. *Japanese Auto-Products*, 1524 HANREI JIHŌ 3, *translated in* Judgment to the Case of NE No. 3272/1994, at 17-18 (July 5, 1995) (unpublished manuscript, on file with the *Loyola of Los Angeles International and Comparative Law Journal*).

172. *See* Slind-Flor, *supra* note 14.

ernment to issue regulations narrowing the ruling or Japan's parliament to overrule it.[173]

Although some have loudly criticized it the *Japanese-Auto* ruling arguably may not have as much impact on U.S.-Japanese relations as its opponents suggest. The real problem regarding U.S.-Japanese relations is limited access to Japanese markets. With the recent trade pact and tightening trade deficit with Japan, however, this problem seems to be waning. Because trademark and patent issues do not significantly affect the trade deficit problem, *Japanese-Auto* may not really jeopardize all that was gained in the pact.

Nonetheless, the *Japanese-Auto* decision will undoubtedly affect foreign companies' ability to do business in Japan, which some opponents of the decision see as the bottom line. Because U.S. products are fervently sought in Japan, U.S. businesses will suffer more than other foreign companies.[174] Despite the trade pact and shrinking trade deficit, the affirmation of *Japanese-Auto* will give further ammunition to critics of Japanese trade practice. Critics will argue that the decision epitomizes Japan's blatant discrimination against foreign businesses. The peace-making missions that Japan sent to Germany and the United States suggest that Japan thinks this opinion will be pervasive.

The *Japanese-Auto* ruling will definitely impact future patent and trademark custom in the international context. The loosening of Japanese trade barriers will enable businesses to sell products in Japan after the first sale in the country of origin. As such sales occur, other countries' courts may follow the Tokyo High Court's lead and rule the same way, which would only lead to greater friction between normally hospitable trading partners.

Matthew R. Hicks*

173. *See id.*

174. Pharmaceutical and agricultural chemical companies are American businesses that would suffer disproportionately if *Japanese-Auto* is not reversed because they "need the exclusivity of the market in Japan to justify the enormous regulatory costs." *Id.* Essentially, *Japanese-Auto* lays a major economic roadblock to innovative companies that develop new drugs and agricultural chemicals. *See id.*

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