Liabilities Under Article 42 of the U.N. Convention on the International Sale of Goods

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INTRODUCTION

The growing volume of international trade has given rise to increased concern for protecting intellectual property rights in international commerce without inhibiting the freedom of commercial transactions. While the Uruguay Round negotiations have addressed broad protection for intellectual property rights per se, the United Nations Convention on Contracts for the International Sale of Goods (1980) (CISG)[1] has created uniform rules to govern international commercial transactions. With this dual objective in mind, CISG Article 42 defines certain rights of parties to international transactions in which the sale of goods may infringe certain intellectual property rights.

The requirement of Article 42 that the seller deliver goods free of third-party intellectual property claims appears to be new in international commercial law.[2] The essence of the obligation is that the seller must deliver goods that, at the time of contracting, were not subject to a third-party right or claim based on intellectual property rights (IPRs) of which the seller knew or should have known. In effect, the seller must indemnify the buyer against certain third-party claims against her with respect to intellectual property rights. The seller's obligation extends only to rights or claims that exist under the law of the state in which the goods will be used or resold, or, in the alternative, under the law of the buyer's own state, and the

* Wiley, Rein & Fielding, Washington, D.C.; University of North Carolina, Ph.D. (1969); George Washington University, J.D. (1990).

1. Convention on Contracts for the International Sale of Goods, Dec. 11, 1986, S. TREATY DOC. NO. 9, 98th Cong., 1st Sess. (1988), 19 I.L.M. 671 (1980), [hereinafter CISG].

An excellent source of information on the CISG for practitioners is the BUSINESS LAWS, INC., GUIDE TO THE INTERNATIONAL SALE OF GOODS CONVENTION (1992, with annual supplements).

2. *See infra* notes 21-26 and acompanying text for background on prior uniform law.

seller is not liable for rights or claims of which the buyer knew or should have known.

This Article first examines the legislative history of CISG Article 42 as a guide to answering four interpretive questions:

1. What is the scope of "industrial property or other intellectual property"? The charter of the World Intellectual Property Organization (WIPO), referred to in the legislative history of Article 42, defines the terms broadly.[3] In the context of the sale of goods, however, only trademark, copyright and patent rights are important.[4]

2. What responsibility is placed on the seller by holding her accountable for information of which she "could not have been unaware"? "Could not have been unaware" can reasonably be interpreted as expressing an idea akin to "ought to have known," though it is a stricter standard subjecting the buyer to a higher degree of proof.[5]

3. Can a seller "know" of a claim that has not yet arisen? Because intellectual property law is territorial, no claim will usually arise under the laws of any State until the goods are imported into that State. Article 42 limits the seller's liability to claims of which she has knowledge at the time of contracting, including knowledge that claims will arise upon import.[6]

4. What is a "State," and is the seller always liable for IPR claims against the buyer arising under the law of just one State? "State" must always be singular, but it could mean both a nation-state and its subordinate jurisdictions, and the law of such a "State" may include supranational intellectual property law.[7]

The second part of this Article examines the practical implications of Article 42 as applied to transactions involving goods imported into the United States and to goods exported from the United States to the United Kingdom (to which a large body of EC law on intellectual property would apply). This discussion is limited to issues in trademark, copyright and patent, and is illustrative only; there are many situations other than those discussed here in which IPR claims will arise.[8]

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3. *See infra* notes 31-35 and accompanying text.
4. *See infra* note 35 and accompanying text.
5. *See infra* notes 41-57 and accompanying text.
6. *See infra* note 58 and accompanying text.
7. *See infra* notes 59-74.
8. Claims might arise even in the absence of an import or export. For example, if a German corporation bought, in the United States, goods manufactured in the United States and then resold them to a second domestic U.S. buyer, both sales would be covered by the CISG. *See* CISG, *supra* note 1, arts. 1,

I. BACKGROUND OF THE CISG

A. HISTORICAL INFORMATION

Efforts to unify international sales law, and thus reestablish the Law Merchant which existed before the rise of modern nation-states, date back to the nineteenth century.[9] In the 1930s, the International Institute for the Unification of Private Law (UNIDROIT) began drafting a uniform sales law, which eventually became a basis for the 1964 Hague Uniform Law of International Sales (ULIS) and the Uniform Law on the Formation of Contracts.[10] Many countries considered these laws unsatisfactory, however, and they were never widely adopted.[11]

In 1968, the United Nations Commission on International Trade Law (UNCITRAL) was created. During the succeeding nine years its Working Group on the International Sale of Goods prepared a draft convention which was submitted, with commentary by the U.N. Secretariat, to the Diplomatic Conference held in March and April of 1980.[12] The United States acceded to the resulting CISG on December 11, 1986, and the treaty entered into force in the United States on January 1, 1988.[13]

In general, the CISG governs only *international* sales,[14] and only *commercial* sales of *goods*.[15] Although its provisions determine whether the parties have formed a sales contract, the provisions neither govern the *validity* of that contract, nor establish when title to the goods passes from seller to buyer.[16] The CISG

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10. If the goods infringed a U.S. patent, there could be an IPR claim against the buyer for which Article 42 would impose liability on the seller.

The point is that the range of possible IPR claims is co-extensive with the intellectual property law which Article 42 selects to apply. There is no attempt here to treat all such situations systematically.

9. *See generally* JOHN HONNOLD, DOCUMENTARY HISTORY OF THE UNIFORM LAW FOR THE INTERNATIONAL SALE OF GOODS CONVENTION (1989) [hereinafter DOCUMENTARY HISTORY] (*Secretariat Commentary*); Amy Kastely, *Unification and Community: A Rhetorical Analysis of the United Nations Sales Convention*, 8 NW. J. INT'L L. & BUS. 574, 579-85 (1988).

10. Kastely, *supra* note 9, at 580. States accepting the CISG must denounce the Hague laws. CISG, *supra* note 1, art. 99(3).

11. Kastely, *supra* note 9, at 580.

12. *Id.* at 582.

13. CISG, *supra* note 1, 19 I.L.M. 671.

14. CISG, *supra* note 1, art. 1(1). Within the United States, of course, Article 2 of the Uniform Commercial Code (UCC) governs the sale of goods. The UCC and the CISG are parallel codes; the former effective in the domestic context, and the latter in the international context. U.C.C. § 2-312 (1992) roughly parallels CISG Article 42. *See infra* note 25.

15. CISG, *supra* note 1, arts. 2(a), 3(2).

16. CISG, *supra* note 1, art. 4. Under some legal systems, title in goods

also does not govern product liability claims.[17]

B. THE CISG IN PRACTICE

The CISG applies to any commercial sale of goods between parties whose places of business are in different signatory states.[18] Contracting parties may, however, affirmatively provide that it shall not govern their contract,[19] preferring instead to rely on other law with which they are both familiar and satisfied. They may also choose to exclude certain articles of the CISG. Because there are substantial uncertainties concerning how the rights provided in Article 42 might be interpreted by a court or an arbitrator, parties involved with intellectual property issues would be wise to contractually exclude Article 42, and specify in their contracts exactly how such issues will be resolved.

Because of the short period in which it has been effective, the CISG has had little interpretation by U.S. courts,[20] and no cases deal with Article 42. Therefore, practitioners and courts alike must rely solely on the legislative history for its interpretation.

C. THE LEGISLATIVE HISTORY OF ARTICLE 42

Prior uniform law on third-party claims was limited to Article 52 of the 1964 Hague Convention relating to the Uniform Law on the International Sale of Goods (ULIS) which provided certain remedies to the buyer in the event of a third-party claim on the goods.[21] Article 52 of the ULIS concerned defects in title,

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passes when the contract is formed; in others it passes at a later time. The CISG does not attempt to unify these rules. DOCUMENTARY HISTORY, *supra* note 9, at 407 (*Secretariat Commentary* 17, art. 4, cmt. 4).

17. CISG, *supra* note 1, art. 5.

18. CISG, *supra* note 1, art. 1. See *id.* art. 10 for a definition of "place of business."

19. CISG Article 6 states, in pertinent part: "The parties may exclude the application of the Convention or, subject to Article 12, derogate from or vary the effect of any of its provisions." CISG, *supra* note 1, art. 6. There is an exception to this rule with respect to statute of fraud issues. *Id.* art. 12.

20. The sole case reported to date dealing with the CISG appears to be Filanto v. Chilewich International Corp., 789 F. Supp. 1229 (S.D.N.Y. 1992) which noted the absence of case law but added that "it may safely be predicted that this will change" because of the broad applicability of the Convention. *Id.* at 1237.

21. Date-Bah, *Third Party Claims in General, in* COMMENTARY ON THE INTERNATIONAL SALES LAW: THE 1980 VIENNA SALES CONVENTION (C.M. Bianca & M.J. Bonell eds., 1987) (summarizing the history of the third-party liability provisions of the CISG).

which may or may not have been a concept broad enough to encompass IPR claims; the generally accepted view was that it did not.[22] The 1977 "sales draft," as presented to UNCITRAL by the Working Group, initially took a clear position: it included only a simple provision on third-party claims,[23] and expressly excluded claims arising from intellectual property rights.[24] While considering the 1977 draft, however, UNCITRAL set up a special Working Group to draft provisions that would cover situations in which third-party claims arose from IPRs. Apparently the drafters believed that while domestic legal systems generally include an obligation to deliver goods free from third-party IPR claims, such an obligation should be strictly limited in international trade.[25] As drafted by the special Working Group, these provisions were part of the article on third-party rights. In fur-

22. ULIS Article 52 protected the buyer against "a right or claim of a third person." Honnold says this did not include claims based on intellectual property, and the secretariat commentary states that there was no prior uniform law, but there is room to disagree. *See* JOHN HONNOLD, UNIFORM LAW FOR INTERNATIONAL SALES UNDER THE 1980 UNITED NATIONS CONVENTION § 268 (1982) [hereinafter UNIFORM LAW]; DOCUMENTARY HISTORY, *supra* note 9, at 426 (*Secretariat Commentary*, art. 40). *But see* Fritz Enderlein, *Rights and Obligations of the Seller Under the U.N. Convention on Contracts for the International Sale of Goods*, *in* INTERNATIONAL SALE OF GOODS: DUBROVNIK LECTURES 133, 181 (Petar Sarcevic & Paul Volken eds., 1986) (noting that at least one scholar believed that ULIS Article 52 *did* cover intellectual property claims, but assigning little importance to this question); PETER SCHLECHTRIEM, UNIFORM SALES LAW 73 (1986) (stating that German civil law and the ULIS both treat third-party IPR claims "simply as defects in title infringing upon the use of purchased goods.").

The drafters of what became CISG Article 42, however, believed that most legal systems generally accepted the obligation they were creating. *See* DOCUMENTARY HISTORY, *supra* note 9, at 426 (*Secretariat Commentary* 36); *cf.* U.C.C. § 2-312(3) (1992) ("[G]oods shall be delivered free of the rightful claim of any third person by way of infringement or the like . . . .").

23. DOCUMENTARY HISTORY, *supra* note 9, at 333 (*VIII Yearbook* 40, para. 210).

24. *Id.* at 323 (*VIII Yearbook* 30, art. 7(b), para. 72). This provision was removed when UNCITRAL adopted the broader provision which became CISG Article 42. *Id.* at 334. (*VIII Yearbook* 41, para. 226).

At the Diplomatic Convention, a minority believed that the CISG should not try to deal with IPRs. In the end, three representatives abstained from the final vote on Article 42 for this reason. *Id.* at 743 (*Secretariat Commentary* 208, art. 40, cmt. 74).

25. The secretariat commentary says, "It appears to be the general rule in most, if not all, legal systems that the seller is obligated to deliver goods free from any right or claim of any third party based on industrial or intellectual property." The commentary also states that while such an obligation is appropriate in domestic sales, liability should be limited in international sales because it is more difficult to obtain the necessary information and because the seller has no control over where the buyer resells or uses the goods. *Id.* at 426-27

ther discussions, however, the drafters decided to provide two separate articles, Article 25 dealing with third-party claims other than those based on IPRs, and Article 26 dealing with IPRs.[26] These provisions were substantively very close to the final form adopted in the CISG as Articles 41 and 42, although their notification provisions were later moved to CISG Article 43.

D. FOUR QUESTIONS OF INTERPRETATION

Article 42 of the CISG obligates the seller to deliver goods to the buyer free of third-party claims based on IPRs.[27] This obligation has five limitations, however. The seller is liable:

(1) only with respect to third-party claims of which he knew or "could not have been unaware";
(2) only if that knowledge existed when the contract was made;

(*Secretariat Commentary* 36-37, art. 40, cmts. 2-4); Enderlein, *supra* note 22, at 179.

Under the UCC, the seller is obligated to deliver goods free of third-party claims related to "infringement." U.C.C. § 2-312(3) (1992). The obligation is limited, however, to merchants selling from their "normal stock" in the "normal course of business," and only to claims based on patent or trademark infringement. *Id.* (official cmt., para. 3).

26. *See* DOCUMENTARY HISTORY, *supra* note 9, at 333-34 (*VIII Yearbook* 40-41, paras. 210-29); Date-Bah, *supra* note 21, at 316-17.

27. Article 42 provides:

> (1) The seller must deliver goods which are free from any right or claim of a third party based on industrial property or other intellectual property, of which at the time of the conclusion of the contract the seller knew or could not have been unaware, provided that the right or claim is based on industrial property or other intellectual property:
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> (a) under the law of the State where the goods will be resold or otherwise used, if it was contemplated by the parties at the time of the conclusion of the contract that the goods would be resold or otherwise used in that State; or
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> (b) in any other case, under the law of the State where the buyer has his place of business.
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> (2) The obligation of the seller under the preceding paragraph does not extend to cases where:
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> (a) at the time of the conclusion of the contract the buyer knew or could not have been unaware of the right or claim; or
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> (b) the right or claim results from the seller's compliance with technical drawings, designs, formulae or other such specifications furnished by the buyer.

CISG, *supra* note 1, art. 42.

The objective of CISG Article 42, as defined by the special working group which drafted it, is to "define the limits of the seller's responsibility . . . based on industrial or intellectual property," and to "indicate which industrial or intellectual property laws were relevant" to determine the obligation. DOCUMENTARY HISTORY, *supra* note 9, at 333 (*VIII Yearbook* 40, para. 215).

(3) only if the buyer did not know and should not have known of the claims;
(4) only if the claims do not arise out of the buyer's instructions with respect to specifications; and
(5) only under the law of one "State": that in which the goods are to be used or resold if the contract or surrounding circumstances make it clear what State this is, or if not, then the State in which the buyer has her place of business.

Subject to the first four conditions, *the seller is liable for any claim by a third party against the buyer that arises out of the intellectual property law of the country determined by condition five.*

Understanding the seller's liability under Article 42 requires consideration of four questions.

1. What is the "industrial property or other intellectual property" to which Article 42 applies?

Several widely recognized international conventions define the terms industrial property and intellectual property. Under the Paris Convention of 1883, as revised at Stockholm in 1967,[28] "industrial property" includes patents, trademarks and related concepts, but not copyrights — perhaps because at about the same time, copyright was made the subject of the Berne Convention for the Protection of Literary and Artistic Works of 1886.[29] The Berne Convention, most recently revised at Paris in 1971, is the basis for most international copyright cooperation. The United States, which participated in the original negotiation of the Berne Convention in 1886, acceded to the convention only in

28. Article 1 of the Paris Convention states in pertinent part:
(2) The protection of industrial property has as its object patents, utility models, industrial designs, trademarks, service marks, trade names and indications of source or appellations of origin, and the repression of unfair competition.
(3) Industrial property shall be understood in the broadest sense and shall apply not only to industry and commerce proper, but likewise to agricultural and extractive industries and to all manufactured or natural products.
Convention of Paris for the Protection of Industrial Property, Mar. 20, 1893, 21 U.S.T. 1583, 828 U.N.T.S. 305, 309, 311 (most recently revised at Stockholm on June 14, 1967).

29. Berne Convention for the Protection of Literary and Artistic Works of 1886, Sept. 9, 1886, 828 U.S.T. 221 (Stockholm revision of 1967). The latest revision, to which the United States has adhered, is the Paris revision of July 24, 1971. *See* 1 Basic Doc. Int'l Econ. L. (CCH) 715 (1990).

1988.[30]

From the standpoint of the CISG, however, the most relevant definition of "intellectual property" is that of the World Intellectual Property Organization (WIPO) because the phrase "industrial property or other intellectual property" was adopted at the Diplomatic Conference at the suggestion of WIPO.[31] WIPO's broad definition of intellectual property encompasses essentially "all . . . rights resulting from intellectual activity in the industrial, scientific, literary, or artistic fields."[32] Thus, any rights related to patents, copyrights, trade or service marks, trade secrets (as a branch of unfair trade), or mask works[33] would fall within the definition.[34] Article 42 is most likely to

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30. Berne Convention Implementation Act of 1988, Pub. L. No. 100-568, 102 Stat. 2853 (1988) (U.S. adherence effective Mar. 1, 1989).

31. The WIPO suggestion, DOCUMENTARY HISTORY, *supra* note 9, at 399 (*Pre-Conference Proposals* 78, art. 40, para. 2), was introduced by Finland, withdrawn after the Greek representative raised a minor objection, then later reintroduced by Argentina and adopted without discussion. Apparently there was no other discussion of what "industrial property or other intellectual property" should mean. *Id.* at 546 (*Proposed Amendments; Action by First Committee* 325, 17th meeting, paras. 45-47); *id.* at 549 (*First Committee Deliberations* 328, paras. 92-93); *id.* at 682 (*First Committee Decision* 110, art. 40, para. B.2); *see also id.* at 426 (*Secretariat Commentary* 36, art. 40, n. 1) (referring to the WIPO convention in defining "intellectual property").

32. Article 2 of the WIPO Convention states:

> (viii) "intellectual property" shall include the rights relating to:
> - literary, artistic and scientific works,
> - performances of performing artists, phonograms and broadcasts,
> - inventions in all fields of human endeavor,
> - scientific discoveries,
> - industrial designs,
> - trademarks, service marks, and commercial names and designations,
> - protection against unfair competition,
>
> and all other rights resulting from intellectual activity in the industrial, scientific, literary or artistic fields.

Convention Establishing the World Intellectual Property Organization, July 14, 1967, 21 U.S.T. 1749, 828 U.N.T.S. 3, 11 (amended by KAV 2464).

33. A trade secret is any information about a process, device, or formula that is useful in business and confers an advantage on its holder because it is not known (or knowable by proper means) to competitors. *See* RESTATEMENT (FIRST) OF TORTS § 757 (1934); 1 MELVIN F. JAGER, TRADE SECRET LAW § 3.01(1) (1992). The process for making a new product, for example, could be protected either by patenting the process or by simply keeping the new process secret.

A "mask work" is the set of images that define the layout of a semiconductor chip product. *See* 17 U.S.C. § 901(a)(2) (1992).

34. Some intellectual property rights are not likely to arise in the context of the sale of goods. Unfair competition is included within the WIPO definition, but much of it, such as false advertising and price discrimination, has nothing to do with IPRs. Trade secrets, a branch of unfair competition, are within the

affect the rights associated with trademarks, copyrights, and patents, because only these rights are likely to be infringed by the sale of goods.[35]

Government restrictions on the sale or use of goods, such as export and import controls or health and safety regulations, are not within the definition. The drafters were concerned early in the drafting process that provisions derived from ULIS Articles 52-53 might be interpreted to apply to government imposed restrictions.[36] One representative even proposed redrafting CISG provisions derived from ULIS Articles 52-53 to cover restrictions imposed by government regulations,[37] but this view was not well received. Most representatives believed that CISG Article 42, like its predecessors in the ULIS, should deal with encumbrances to title; government restrictions seldom went to matters of this sort, and could thus be better handled through other provisions.[38] This view was finally adopted. In the CISG, claims arising from government restrictions must be dealt with under Articles 30 and 35,[39] or under other law.[40]

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concept of IPRs, but the trade secret owner's action is against the party who acquires the secret improperly. ROGER SCHECHTER, UNFAIR TRADE PRACTICES AND INTELLECTUAL PROPERTY 137-38 (1986). A third party who innocently acquires a trade secret is not liable for its use prior to being notified that the information is secret, and may not even be enjoined from future use if it has changed its position in the meantime. *Id.* at 136.

An analogous rule applied to process patents until the Process Patent Amendment Act of 1988 amended 35 U.S.C. § 154 to provide that use or sale of a product made in violation of a process patent infringes the patent. Under the old rule the remedy was only against the manufacturer who actually used the process. Omnibus Trade and Competitiveness Act of 1988, Pub. L. No. 100-418, § 9002, 102 Stat. 1107, 1563 (amending 35 U.S.C. § 154); *see also* 4 DONALD S. CHISUM, PATENTS § 16.02[6] (1989). At least under U.S. law, a good faith buyer should not be liable on a trade secret theory if the goods turn out to have been made through use of a stolen trade secret.

35. Under the UCC, the seller's obligation is limited to claims based on patent or trademark infringement. *See supra* note 25. If this is typical of other legal systems, and if the purpose of CISG Article 42, as stated by the secretariat commentary, *id.*, is to further limit the obligation imposed by domestic law, then there is an argument that only patent and trademark are intended to be within the definition.

36. *See* DOCUMENTARY HISTORY, *supra* note 9, at 107 (*III Yearbook* 90, paras. 128-30).

37. *Id.* para. 128.

38. *Id.* paras. 128-130, 138; *id.* at 334 (*VIII Yearbook* 41, para. 220); *Id.* at 426 (Sec. Comm. 36, art 34, cmt. 5).

39. SCHLECHTRIEM, *supra* note 22, at 73.

40. DOCUMENTARY HISTORY, *supra* note 9, at 334 (*VIII Yearbook* 41, para. 220).

2. What standard is meant by "could not have been unaware"?

This is the most difficult question Article 42 raises. The seller is liable for third-party claims of which she "knew or could not have been unaware."[41] Because the language appears redundant, the phrase "could not have been unaware" must be a term of art.[42]

The secretariat commentary states that "the seller 'could not have been unaware' of the third-party claim if that claim was based on a patent application or grant which had been published in the country in question."[43] This appears to place an affirmative obligation on the seller to research the patent (and by analogy, copyright and trademark) registries of the country in which the buyer will use or resell the goods. The secretariat commentary reinforces this view by stating further that "[T]he seller is in a position to ascertain whether any third party has industrial or intellectual property rights or claims . . . ."[44] The legislative history, however, does not support the Secretariat's view. The International Chamber of Commerce (ICC) commented to the Diplomatic Conference that the Secretariat's view was incorrect.[45] But there is no indication that this criticism was accepted or even debated, nor is there an indication of the standard that the ICC would have applied.

Schlechtriem takes a position at least as broad as the Secretariat: the seller "must inform himself about the possible industrial or other intellectual property rights of third persons with regard to the goods sold."[46] At the opposite extreme, Huber argues that the seller is liable only for fraudulently maintaining silence about IPRs of which she has actual knowledge.[47]

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41. CISG, *supra* note 1, art. 42(1).

42. Clearly, one who "could not be unaware" must be "aware," and therefore must "know." A more familiar phrasing would be "knew or should have known." That the phrase must be a term of art is shown by the fact that during drafting negotiations, a suggestion that it be dropped as a tautology was rejected. *See infra* notes 51-53 and accompanying text.

43. DOCUMENTARY HISTORY, *supra* note 9, at 427 (*Secretariat Commentary* 37, art. 40, cmt. 6). The "country in question" is the country in which the goods are to be used or sold, if that country is identified by the context of the transaction, or failing that, the buyer's country. *See infra* text accompanying notes 59-74.

44. *Id.* at 427 (*Secretariat Commentary* 37, art. 40, cmt. 5).

45. *Id.* at 399 (*Pre Conference Proposals* 78, art. 40, para. 5).

46. SCHLECHTRIEM, *supra* note 22, at 74.

47. *Id.* at n. 284. Schlechtriem criticizes this as far too narrow an interpretation.

One approach to finding the middle ground between Schlechtriem and Huber is to look for consistent use of the phrase within Article 42. Seller is not liable if *buyer* knows or "could not have been unaware" of the right or claim.[48] Does this mean that buyer has the same duty as seller to learn of IPRs? The phrase used is the same; it should mean the same thing in both places.[49] If, however, both seller and buyer have the same obligation to learn of published intellectual property rights, the buyer's duty negates the seller's obligation: if seller "could not have been unaware" neither could buyer, so seller is not liable.

Does this deprive the phrase of any meaning at all? Certainly not. Regardless of whether either seller or buyer has a duty to learn of *published* IPRs, both may have a duty to learn of rights through information that is *routinely* or *uniquely* in their possession. Thus, if seller holds patent rights on the goods, he might reasonably be expected to know whether these rights have been licensed in buyer's country, and if so, to whom. Alternatively, buyer, holding a license to use a trademark in country B, might be held responsible for knowing that in country C the same trademark is licensed to another, while seller might be a wholesaler unaccustomed to selling to either country B or C, and thus unlikely to know of such licenses. In such situations it might be perfectly appropriate to hold one side or the other responsible for knowledge of the pertinent IPR.[50]

The legislative history of "could not have been unaware" as the phrase is used in Article 8 of the treaty supports this interpretation.[51] In the negotiations leading up to the diplomatic conference at which the treaty was finally considered, the U.K. representative suggested that "knew or could not have been unaware" stated a tautology, and that the second part of the phrase should be dropped.[52] The secretariat commentary, while not ad-

48. CISG, *supra* note 1, art. 42(2)(a).

49. *But see* Enderlein, *supra* note 22, at 182 (asking "Is [buyer] obliged to conduct research regarding the patent situation in his country or the country of destination? I don't think so.").

50. Under the UCC, a person has "notice" of a fact when "from all the facts and circumstances known to him at the time in question he has reason to know that it exists." U.C.C. § 1-201(25)(c) (1992). Such a person cannot escape liability by willfully remaining ignorant of facts that would have been discovered by questions a prudent person would ask under the circumstances. The phrase "could not have been unaware" used in CISG Article 42 may impose an analogous duty.

51. CISG Article 8 discusses the extent to which knowledge of one party's intent is to be imputed to another party. CISG, *supra* note 1, art. 8.

52. DOCUMENTARY HISTORY, *supra* note 9, at 394 (*Pre Conference Proposals* 73, art. 7, para. 3).

dressing the point directly, appeared to equate "could not be unaware" with "had no reason [not] to know."[53] Subsequent discussions in the First Committee dipped into Kantian philosophy at one point but can fairly be read to mean that "could not be unaware" expresses an idea akin to "ought to have known," but is a stricter standard requiring a higher degree of proof.[54] Certainly there is nothing in this discussion that suggests that the phrase places an affirmative obligation on the seller to search for information that is not readily discoverable in the circumstances that precede and surround the contract negotiations.

Finally, one might approach the question from the standpoint of commercial practicality, asking *when* the duty to learn of IPR claims, if there is one, arises. Seller's liability is limited to claims of which she knew or could not have been unaware "at the time of conclusion of the contract."[55] What the seller learns after the contract is made is irrelevant. This militates against the seller's broad duty to research possible IPR claims in buyer's country. Such research would often be impractical where seller receives an order for goods under commercial circumstances requiring a prompt decision to accept or reject the offer. But it would be perfectly rational to hold seller responsible for information that would reasonably be expected to be in her possession at the time of contracting (such as the patent licenses suggested above).

Thus, there are three good arguments that the broad interpretation of "could not have been unaware" that the Secretariat and Schlechtriem suggested is incorrect. The same conclusion follows whether one approaches the problem as a matter of consistent interpretation within Article 42, of consistent interpretation between Article 8 and Article 42,[56] or as a matter of commercial practicality. But these arguments do not force one back to Huber's narrow "fraudulent silence" interpretation. Something in between is more reasonable.

The most logical interpretation is that "could not have been unaware" places a duty on both seller and buyer to not be negli-

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53. *Id.* at 408 (*Secretariat Commentary* 18, art. 7, cmts. 3-4).

54. *Id.* at 480-81 (*First Committee Deliberations* 259-60, 6th meeting, art. 7, paras. 3-19). Perhaps the best interpretation is that the seller is liable in circumstances such that a judge could not believe that she did *not* know. *Id.* at 481 (*First Committee Deliberations* 260, 6th meeting, art. 7, para. 6).

55. CISG, *supra* note 1, art. 42(1).

56. Elsewhere in the CISG, the phrase "could not have been unaware" is used only in Articles 35 and 40. The legislative history of those articles throws no light on the subject.

gent about information that is reasonably at hand at the time they form a contract, especially if the other side is not likely to have the same information. The buyer's burden of proof is fairly heavy, perhaps close to gross negligence. Thus, the seller's liability may be limited to situations in which circumstances make it impossible for a judge to believe that seller did *not* know of the information at issue.[57]

3. Can a seller "know" of a claim which has not yet arisen because the goods have not yet been imported to the State under the laws of which IPR claims may be brought?

Because intellectual property law is highly territorial, there will usually be no claim until the goods are actually imported. The seller's liability, however, is limited to claims of which he has knowledge at the time of contracting. Thus, when the contract is made before the goods are imported, there can be no liability unless seller can "know" of a claim which has not yet arisen.

The best argument that Article 42 should be interpreted to impose liability in such cases is that the alternative would make the entire article meaningless except when the goods are imported *before* the sales contract is made. In such a case, however, the IPR holder would have a direct action against seller, so there would be little need for Article 42. This interpretation would also come close to violating the canon that a legal provision should not be interpreted so as to deprive it of all meaning. It is unlikely that the drafters intended to impose liability only in such exceptional cases.

Domestic law provides a useful analogy, but one that is imperfect because it does not involve the import question. The UCC provides that the seller's liability extends to claims related to patent or trademark that "*will* mar the buyer's title."[58] By analogy, seller's liability should extend to claims which she "knew," at the time the contract was made, would arise upon import.

4. Is seller's obligation to know of IPR claims always restricted to just one State?

The seller is liable with respect to claims:
(a) [U]nder the law of the State where the goods will be re-

57. *See supra* note 54.
58. U.C.C. § 2-312 (1992) (official cmt., para. 3) (emphasis added).

> sold or otherwise used, if it was contemplated by the parties at the time of the conclusion of the contract that the goods would be resold or otherwise used in that State; or
>
> (b) [I]n any other case, under the law of the State where the buyer has his place of business.[59]

"State" is always used in the singular.

An initial difficulty in determining seller's liability is establishing whether the parties "contemplated," when the contract was made, a particular "state" in which the goods would be used or resold. Presumably the parties could "contemplate" outside of the contract itself, and might anticipate different destinations for the goods at different times.[60] Seller is not bound by the buyer's private contemplations — the "parties" must do the contemplating — but if these contemplations are unclear, buyer might assert liability against seller for IPR claims arising in several different countries.[61] Seller should insist on clarity on this point in the contract.

Assuming that the contemplations of the parties are clear, there remains a question of whether "State" means only a nation-state competent to be party to the Convention, or is more encompassing. Enderlein says the "seller's responsibility . . . always applies only to one country . . . ."[62] He clearly believes that "State" means country. That view is supported by the fact that "State" is capitalized in Article 42 just as it is in the preamble and in Article 1, where it is clearly limited to a nation-state competent to adhere to the Convention.

Such a narrow definition is unsatisfactory, however, because not all intellectual property law is national law. For example, U.S. patent and copyright laws are almost entirely federal, but both federal and state law protect trademarks, and trade secrets are protected mainly under state doctrines.[63] Yet all these forms of intellectual property are clearly within the definitions

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59. CISG, *supra* note 1, art. 42(1). "Place of business" is defined in *id.* art. 10 as: "that which has the closest relationship to the contract and its performance, having regard to the circumstances known to or contemplated by the parties at any time before or at the conclusion of the contract."

60. "Contemplations" after the contract is made, however, are irrelevant. *Id.* art. 42(1).

61. Because Article 42 says "*the* State," it unlikely that buyer could simultaneously assert claims based on the law of more than one State. The important question will be *which* State's law is invoked. CISG, *supra* note 1, art. 42(1)(a).

62. Enderlein, *supra* note 22, at 181.

63. Trademarks are protected under the Lanham Act, 15 U.S.C. §§ 1051-1128 (1988), but also under various state statutes and common law doctrines.

used in the Paris Convention[64] and by WIPO.[65] If the buyer is to be protected against third-party rights based on all these kinds of intellectual property, "State" must include a state of the United States as well as the United States itself. Therefore, "State" must mean a nation-state and its subordinate jurisdictions.

Intellectual property law is increasingly supranational law as well. The European Community has made progress toward both a Community trademark and a Community patent.[66] A significant body of law on the application of IPRs, especially as it affects unfair competition and antitrust, is now Community law.[67] Moreover, the United States is seeking to establish "substantive standards in the areas of patents, copyrights, trademarks, trade secrets, and semiconductor chip layout designs" in the GATT Uruguay Round;[68] as is the European Community.[69]

The doctrines of "direct application" and "direct effect," which incorporate community law into national law and where necessary preempt it, are well established in the European Com-

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See JEROME GILSON, TRADEMARK PROTECTION AND PRACTICE § 1.04[2][a]&[b] (1989).

Trade secrets, however, are protected primarily under state common law tort doctrines. *See, e.g.*, Goodrich v. Wohlgemuth, 192 N.E.2d 99 (Ohio 1963) (enjoining a former employee from using secret information in new employment). Trade secrets are not important in the context of CISG Article 42. *See supra* note 34.

64. *See supra* note 28.

65. *See supra* note 32.

66. *See* AUDREY WINTER ET AL., EUROPE WITHOUT FRONTIERS: A LAWYER'S GUIDE 128-30 (1989). Although it had been expected that the European Community Patent and European Community Trademark, which would provide protection throughout the European Community on the basis of a single filing, would be available by the beginning of 1993, conflicts over siting the new offices and the languages to be used have delayed implementation. *See EC Leaders Agree on Institutions's Siting, Improving Patent, Trademark Rules*, Int'l Bus. Daily (BNA) (Dec. 15, 1992), *available in* LEXIS, Nexis Library, BNAIBD File.

67. *See generally* David Vaughn, *Competition*, *in* 52 HALSBURY'S LAWS OF ENGLAND §§ 19.325-19.52 (4th ed. 1986) (dealing with the *exercise* of intellectual property rights); WINTER, *supra* note 66, at 127-33.

68. C. Michael Hathaway, *A New Dimension for Trade Policy: The Protection of Intellectual Property*, INT'L L. NEWS, Summer 1989, at 3. The United States tabled a draft agreement on trade related aspects of intellectual property rights (TRIPs) in the Uruguay Round in May, 1990. Int'l Trade Rep. (BNA) (May 16, 1990). As of late 1992, Uruguay Round negotiations continued to move slowly. *See GATT Talks Run Against the Clock*, FIN. TIMES, Dec. 11, 1992, at 5.

69. *Draft Agreement on Trade Related Aspects of Intellectual Property Rights*, GATT Doc. MTN.GNG/NG11/W/68 (Mar. 27, 1990) (EC proposal to GATT Negotiating Group on Trade Related Intellectual Property Rights).

munity.[70] Thus, if the relevant State for purposes of Article 42 is a member of the European Community, community law *is* national law. In other cases, a State might have accepted international law, yet still have conflicting national law in effect. A third party might legitimately base an IPR claim on either or both sets of laws, raising questions as to whether seller would be liable under Article 42.

Although the member states of the European Community are increasingly becoming part of an integrated market in which there is free movement of goods,[71] seller is probably not subject to liability based on the laws of more than one state. The CISG language requires the parties to "contemplate" use of the goods in "*the* State."[72] Additionally, the parties to the Convention are member states of the European Community; the European Community itself is not a party.[73] Thus, it seems likely that at this time, "State" could not be interpreted to mean the European Community. The fact that the legislative history almost always uses the phrase "the State" strengthens the interpretation that "State" means a signatory nation-state and its subordinate jurisdictions.[74]

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70. *See* John Usher, *Application of Community Law in National Courts*, *in* 51 HALSBURY'S LAWS OF ENGLAND §§ 3.41-3.42 (4th ed. 1986). "Direct application" is the doctrine by which EC treaties and regulations automatically become part of national law, even in countries whose own legal systems do not make it so. *Id.* at § 3.41; *see* Case 6/64, Costa v. ENEL, ECR 585 (1964), *reprinted in* Common Mkt. Rep. (CCH) ¶ 8023 (1965) at 7390. "Direct effect" goes further; it establishes that certain elements of EC law may act directly "to create rights and obligations enforceable by individuals before their national courts," rather than simply binding the member states themselves. Usher, *Id.* at § 3.41.

71. TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [EC TREATY], tit. I, arts. 9-37. Free movement within the European Community of goods admitted properly to any member state is a key element of EC law.

72. CISG, *supra* note 1, art. 42(1)(a).

73. Of the European Community member states, Denmark, Germany, France, Italy, Netherlands, Norway, and Spain have acceded to the CISG as of May 1992. The European Community is not a party to the CISG. BUSINESS LAWS, INC., *supra* note 1, at 100.05-.09.

74. The only apparent exception is a statement that "The seller breaches . . . if a third party has [an IPR claim] under the law of *a* state where the goods are to be resold . . . ." DOCUMENTARY HISTORY, *supra* note 9, at 427 (*Secretariat Commentary* 37, art. 40, cmt. 5) (emphasis added). An argument that this allows a plural interpretation of "State," however, could be countered by noting UNCITRAL's statement that the objective of limiting the seller's liability "was achieved by selecting the law of *the* State where the goods would be used . . . ." *Id.* at 333 (*VIII Yearbook* 40, para. 215) (emphasis added).

II. HOW MIGHT ARTICLE 42 APPLY IN PRACTICE?

The foregoing discussion of Article 42's reach and effect has been quite abstract, as it must be in the absence of cases interpreting these provisions in specific factual situations. In an attempt to reduce this level of abstraction, the following section describes a number of situations under U.S. or EC law in which Article 42 liability could arise. Because intellectual property rights vary depending on the jurisdiction and particular factual scenario, this section is solely illustrative, and intended only to provide a feel for how Article 42 might work in practice. The discussion is limited to patent, copyright and trademark, and undoubtedly there are many other fact patterns involving even these forms of IPRs that could arise. The application of Article 42 could also vary greatly in other jurisdictions. The discussion is organized around the country to which the goods are imported because the seller's liability under Article 42 is predicated on third-party claims against the buyer under the law of the country in which the goods will be resold or used, or the country of the buyer's place of business.

A. COPYRIGHT OR PATENT INFRINGEMENT BY IMPORTS INTO THE UNITED STATES.

An item that would have infringed a U.S. copyright or patent if it had been made in the United States infringes similarly when made abroad and imported in at least three situations:

(a) An item protected by U.S. copyright that is manufactured abroad without a license from the copyright owner cannot legally be imported into the United States.[75] Such an item would be a "pirate" copy, to be distinguished from a "gray market" copy.[76] If the infringement is deliberate ("criminal infringement") goods so imported may be seized and forfeited.[77]

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75. 17 U.S.C. § 602(b) (1988) ("where the making of the copies or phonorecords would have constituted an infringement of copyright if this title had been applicable, their importation is prohibited.").

76. If only a trademark has been counterfeited, the issue is not one of copyright. The Tariff Act of 1930 § 526, 19 U.S.C. § 1526 (1988), generally makes it unlawful to import goods bearing a trademark registered in the United States without permission of the trademark holder. The goods may be seized by Customs pending decisions of the trademark holder, but the remedies are generally limited to obliterating the trademark or re-exporting the goods. *See infra* notes 81-89 and accompanying text.

77. 17 U.S.C. § 509(a) (1988). "Criminal infringement" is that done "willfully and for purposes of commercial advantage or private financial gain . . . ." *Id.* § 506(a); *see* 3 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 14.11[B] (1992) (reviewing customs regulations for enforcing § 602(b)).

(b) An item made overseas that would infringe a U.S. patent if made in the United States, infringes if imported and used or sold in the United States.[78]

(c) An item that is itself not patented but is made abroad by a *process* patented in the United States infringes the process patent if imported without authority of the patent owner.[79]

In each of these circumstances, a U.S. buyer's violation of copyright or patent law would give rise to a claim by the copyright or patent holder against the buyer, and Article 42 would give the buyer an offsetting claim against the seller.[80]

B. "GRAY MARKET" IMPORTS TO THE UNITED STATES.

"Gray market" refers to trade in goods for which the owner has licensed the trademark, copyright, or patent with respect to certain countries or other geographic areas, but which are traded within those areas outside the terms of the license. To the extent that a trademark, copyright or patent owner or licensee may prevent goods from moving into a licensed area outside of the terms of the license, the seller of gray market goods may be liable to the buyer under Article 42.

1. Trademark

The leading case addressing gray market imports of trademarked goods is *K-Mart v. Cartier, Inc.*,[81] which interpreted section 526 of the Tariff Act of 1930.[82] *K-Mart* treated three gray market scenarios:

Case 1 involves a foreign manufacturer that licenses its trademark to a domestic U.S. firm, which then imports and dis-

78. 35 U.S.C. § 271(a) (1988). Pirate goods manufactured overseas in violation of a U.S. patent may sometimes be excluded at the border. 19 U.S.C. §§ 1337, 1337(a) (1988); *see* CHISUM, *supra* note 34, § 16.05[3] (1989).

79. 35 U.S.C. § 271(g).

80. In addition to protection under the patent laws, section 337 of the Tariff Act of 1930 provides that a domestic industry injured by "unfair acts in the importation of articles into the United States" may petition the International Trade Commission for an order excluding the articles concerned. 19 U.S.C. § 1337(a), (d) (1988). Imports of articles infringing patents are within the scope of such "unfair acts." *Id.* § 1337(a); In re Amtorg Trading Corp., 75 F.2d 826 (C.C.P.A. 1935); In re Orion Co., 71 F.2d 458 (C.C.P.A. 1934). Because section 337 of the Tariff Act provides for future exclusion of the infringing goods, rather than a right of action against the buyer, CISG Article 42 is not implicated.

81. K-Mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988).

82. 19 U.S.C. § 1526 (1988).

tributes the trademarked goods in the United States.[83] The question was whether such a licensee, which may have paid a substantial fee for the trademark license, may then prevent the foreign manufacturer itself or a third party from importing the trademarked goods and selling them in the United States in competition with the licensee. Congress passed section 526 to protect the U.S. licensee in this situation. As interpreted, the rule is that the U.S. licensee is protected so long as she has independently developed goodwill in the United States through service, warranty programs, advertising or the like.[84] A U.S. third-party buyer of such non-licensed goods would thus be subject to a claim by the licensee based on the trademark license; Article 42 would give the buyer an offsetting claim against the overseas seller.

Case 2 involves a U.S. firm that imports and distributes in the United States, under a U.S. trademark, goods that are manufactured abroad by an affiliated firm. Variations include a U.S. subsidiary of a foreign firm (Case 2a), a foreign subsidiary of a U.S. firm (Case 2b), or an unincorporated overseas manufacturing division of a U.S. firm (Case 2c) importing the goods.[85] *K-Mart* held that if the trademarked goods were sold abroad to a third party in a Case 2 scenario, the goods could be imported freely into the United States and sold in competition with the U.S. owner of the trademark; this ruling upheld long-standing Customs regulations denying protection in this situation.[86] The apparent rationale is that the owner of the trademark, whether in the United States or abroad, can prevent such sales by refusing to sell to the third party in the first place. Because *K-Mart* denied the domestic trademark owner relief, this situation would not give rise to a third-party IPR claim under Article 42; raising no issue of liability for the foreign seller.[87]

Case 3 involves a domestic trademark holder that licenses his trademark to a foreign manufacturer for use in a designated overseas territory. *K-Mart* held that the U.S. licensor is pro-

83. *K-Mart*, 486 U.S. at 286.

84. *See, e.g.*, Osawa & Co. v. B&H Photo, 589 F. Supp. 1163 (S.D.N.Y. 1984) (U.S. licensee of "Mamiya" camera trademark could prevent parallel importation and sale of such cameras under that trademark).

85. K-Mart, 486 U.S. at 286-87. Note that transfers to or from an unincorporated subsidiary would not be sales, and thus would not be covered by the CISG.

86. *Id.* at 287-291.

87. In the case of a U.S. firm importing the products of its own unincorporated overseas manufacturing division, there would be no sale, therefore the CISG would be inapplicable.

tected against imports of the foreign manufactured goods carrying the licensed trademark by either the licensee or a third party.[88] A buyer importing such goods into the United States would be vulnerable to the U.S. licensor's IPR claim, and Article 42 would give him an offsetting claim against the licensee-seller.[89]

2. Copyright

K-Mart clarifies U.S. law with respect to trademarks, but it says nothing about copyright and patent situations.[90] The copyright statute itself, however, is fairly clear. The general rule is that importing an item which is copyrighted in the United States, without permission of the copyright owner, infringes the copyright even if the item was lawfully manufactured abroad (presumably under license from the U.S. copyright owner).[91] If the item is a pirate copy (i.e., manufactured without benefit of a license), Customs can stop it at the border, but if the overseas manufacture is licensed, the copyright holder's only remedy is an infringement suit after importation.[92] Thus, the distinctions elaborated in *K-Mart* are not relevant to copyright; the copyright statute protects the copyright owner against gray market imports into the United States.[93] A third-party copyright owner would have a claim against a buyer who, without permission, imports or subsequently uses or sells a copyrighted item manufactured abroad, whether done under color of license or not; Article

88. K-Mart, 486 U.S. at 287.

89. Assuming, of course, that the United States was the country in which use or resale of the goods was contemplated in the contract, or, in the absence of such contemplations, the country of the buyer's place of business.

90. There was no majority in *K-Mart* behind any consistent theory; the holding on Case 2 was by a majority of 6-3; that on Case 3 was by a different majority of 5-4. This dichotomy alone would make its extension to copyright and patent situations problematic. In addition, copyrights and patents involve concepts and policy considerations very different from trademarks.

91. 17 U.S.C. § 602(a) (1988); *see also* H.R. REP. NO. 1476, 94th Cong., 2d Sess., 169-70, *reprinted in* 1976 U.S.C.C.A.N. 5659, 5785-87. There are exceptions covering imports for the use of the government, an individual traveler, and scholarly purposes.

92. 17 U.S.C. § 602(b) (1988); H.R. REP. NO. 1476, at 170.

93. *See* 2 NIMMER, *supra* note 77, § 8.12[B][6]. The copyright statute explicitly covers situations analogous to K-Mart Case 3 and Case 2b (foreign subsidiary of U.S. corporation). But under various international copyright agreements, most importantly the Berne Convention, *supra* note 30, the work of an author who is a national of or resident in a Convention member country, or work first published in such a country, is protected as of it were a U.S. work. That would appear to provide the same protections for K-Mart Case 1 and Case 2a (U.S. subsidiary of foreign corporation).

42 would generally give the buyer a claim against the seller for the resulting damages.

3. Patent

Although the patent statute is clear with respect to the right to exclude pirate goods manufactured outside the United States, the right to exclude gray market goods depends on case law developed primarily in the area of interaction of patent and antitrust law, and is neither simple nor well-settled. Under the "first sale" doctrine, the sale of a patented article exhausts the monopoly; the buyer is free to resell as he pleases.[94] Under other doctrines, however, a patent owner is generally free to license the use of his patent in a particular territory. Some cases illustrate how parties' rights are resolved in situations analogous to *K-Mart:*

K-Mart Case 1: In *Brownell v. Ketcham Wire and Mfg. Co.*,[95] the Ninth Circuit upheld a patent license in a context analogous to *K-Mart* Case 1: a foreign patent holder licensed its patent to a U.S. corporation for use in the United States, agreeing not to export its own product to the United States; the U.S. licensee similarly agreed not to export to any foreign country. Although the court suggested that the arrangement might have to be tested under antitrust doctrines, it found the arrangement legal as a matter of patent law; violation of the agreement by either side would infringe the license.[96] A U.S. third-party buyer from the foreign licensor would be liable to the U.S. licensee for infringing the license, and Article 42 would give him an offsetting claim against the seller. This is entirely reasonable because the seller obviously would have to know about the license. A third party buying from the foreign patent holder overseas, however, would not thereby violate the U.S. licensee's rights, and the first sale doctrine would allow him to export freely to the United States. Neither the U.S. buyer nor the foreign exporter would be subject to a third-party IPR claim; consequently, Article 42 would not come into play.

K-Mart Case 3: Beckton, Dickenson & Co. v. Eisele & Co.[97] is the leading case illustrating *K-Mart* Case 3 in the patent context.

94. *See* Keeler v. Standard Folding Bed Co., 157 U.S. 659 (1895) (buyer of patented goods from the patentee could resell them even within the exclusive territory granted to a third-party patent licensee); CHISUM, *supra* note 34, § 22 16.03[2] (1989).

95. 211 F.2d 121 (9th Cir. 1954).

96. *Id.* at 129; *see* 5 CHISUM *supra* note 34, § 19.04[3][h] (1992).

97. 86 F.2d 267 (6th Cir. 1936).

The case involved a U.S. owner of a patent on a special steel that gave an exclusive license to a foreign manufacturer to make, and sell in the United States, a particular item made from the steel. The court broadly upheld the right of the licensee to restrict the way it would sell the product in the United States.[98] However, if the licensee were to sell overseas to a third party who then imported the steel into the United States, the first sale doctrine would prevent an action for infringement of the patent.[99] Article 42 would not apply because in this situation, the first sale doctrine would preclude a violation of U.S. patent law.

K-Mart Case 2: By extension of the reasoning behind Case 1 and Case 3, it would appear that licensing agreements between a U.S. firm and its foreign subsidiary, or a foreign firm and its U.S. subsidiary, would be upheld, but that in both situations the first sale doctrine would prevent an action against a third-party seller who exported to a U.S. buyer outside of the license arrangements.

In summary, U.S. law as propounded in *K-Mart* protects trademark owners or licensees against gray market imports in Cases 1 and 3, but not in Case 2. In effect, *K-Mart* refused to recognize the first sale doctrine in Cases 1 and 3, but did recognize it in Case 2. With respect to copyright, the statute grants protection in all three cases, including situations involving a third party, because the first sale doctrine in copyright does not apply unless the item is both made and sold in the United States. Finally, there is patent-based protection against gray market competition between patent licensors and licensees, but not between third parties and either licensees or licensors, because the first sale doctrine *does* apply.[100] In each instance in which *K-Mart* or the relevant statute protects the IPR holder, Article 42 gives the buyer a cause of action against the seller for any liability resulting from the breach of the domestic trademark, copyright or patent.

C. IMPORTS INTO THE UNITED KINGDOM (WITH CONSIDERATION OF EUROPEAN COMMUNITY LAW).

Intellectual property protection in the United Kingdom is broadly similar to U.S. law, although there are differences in detail. European Community law, however, limits the exercise of

98. *Id.* at 269-70.

99. *Id.* at 270; *see* 5 CHISUM, supra note 34, § 19-04[3][h] (1992).

100. Note that the only cause of action is against the licensee seller, not the buyer. CISG Article 42 is not relevant.

rights granted by national law; it considers intellectual property rights in the context of competition, and, at least *within* the European Community, tends to resolve the tension against the IPR holder and in favor of free markets.[101] Thus gray market imports, in general, are allowed regardless of national law.

1. Trademark

Although the U.K. trademark statute includes provisions whereby a trademark holder may prevent imports that would infringe the mark in the United Kingdom,[102] under EC law a trademark holder may not use the mark to partition markets and thereby restrain trade.[103] The European Court of Justice (ECJ) held that Article 30 of the Treaty Establishing the European Community[104] forbade restrictions on the free movement of goods, and that the exception to this rule for matters of industrial property contained in Article 36 of the Treaty[105] had to be narrowly construed and limited to the "specific subject matter" of the right concerned.[106] With respect to trademarks, the ECJ held that the specific subject matter was the "exclusive right to use that trademark, for the purpose of putting products protected by the trademark into circulation for the first time . . . ."[107] In other words, once the goods were sold lawfully bearing the trademark, the holder exhausted his rights and could not prevent gray market imports. This is a strong version of the "first sale" doctrine.

A subsequent case, *Terrapin v. Terranova*, illustrates the line, under EC law, between unacceptable use of a trademark to prevent gray market imports and acceptable use to prevent consumer confusion.[108] A German manufacturer of building materials that used the trademark "Terranova" previously, suc-

101. *See* Vaughn, *supra* note 67, paras. 19.326-28 and para. 19.333.

102. *See* Robin Jacob & Martin Howe, *Trade Marks, Trade Names and Designs*, *in* 48 HALSBURY'S LAWS OF ENGLAND paras. 85-92 (1984).

103. *See id.* para. 102.

104. "Quantitative restrictions on imports and all measures having equivalent effect shall . . . be prohibited between Member States." EC TREATY, *supra* note 71, at art. 30.

105. "The provisions of Articles 30 to 34 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of . . . the protection of industrial or commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States." *Id.* at art. 36.

106. Case 16/74 Centrafarm v. Winthrop E.C.R. 1183, 1194 (1974).

107. *Id.*

108. Case 119/75 Terrapin v. Terranova E.C.R. 1039 (1976).

cessfully opposed German registration of "Terrapin" — the independently-adopted trademark of an unrelated English building materials manufacturer who wished to expand into Germany — because under German law, the two trademarks and the products they identified were similar enough to risk confusing the customer. In a subsequent action, Terranova successfully prevented Terrapin from actually using its mark in Germany. The ECJ distinguished this situation from gray market imports, and agreed that a national court could, on the basis of a finding of possible confusion, restrain imports using the confusing mark.[109]

The ECJ has also accepted the argument that trademarks or other intellectual property rights involving an "open" exclusive license may be justified on grounds of the economic risk that the licensee accepts in developing a market for a new product.[110] But such a license, by definition, does not seek to restrain third-party, gray market importers.

Thus, EC law will always allow parallel imports of goods to which the mark has been applied under license. Consequently, a seller need not be concerned with Article 42 liability for third-party claims against the buyer based on gray market, lawfully trademarked goods imported into the United Kingdom from other European Community member states. A U.S. seller exporting goods directly to the United Kingdom cannot rely on the EC doctrines, however, and therefore must be aware of the more restrictive rule applied under U.K. national law.[111]

2. Copyright

The U.K. copyright rule is clear: the copyright holder has a cause of action against one who imports into the United Kingdom an article whose manufacture infringed the copyright or would have infringed it if the law had applied where the article was manufactured. Under the statute, it does not matter whether the copyright owner has licensed the copyright in an-

109. *Id.* at 1062.

110. Case 258/78 Nungesser v. Commission E.C.R. 2015, 2069-71 (1982). An "open" exclusive license binds the licensor not to compete with the licensee or to license others to do so, but, in contrast with a "closed" exclusive license, does not seek to confer "absolute" territorial protection on the licensee by restraining gray market imports. *Id.* at 2068.

111. Because the EC rules would not be applied to a direct import from the United States to the United Kingdom, it might appear that some protection against gray market imports of this sort could be achieved. But this is not likely; it would be easy to import the goods to another EC country first (where the U.K. trademark holder would not be protected) and then re-export the goods to the United Kingdom as inter-EC trade.

other country; what matters is whether the copyright owner has licensed the import.[112] This appears to grant both pirate and full gray market protection, although in contrast with the American rule, the importer of such a product infringes only if he knows or has reason to know of the copyright infringement.[113]

As in the case of trademarks, however, the U.K. statute must be interpreted consistently with the EC Treaty. The ECJ has held that in the case of a tangible article such as a book, the copyright owner exhausts his right when he sells or authorizes another to sell the book in a member state of the European Community.[114] Again, this is a first sale doctrine, and it is stronger than that applied in the United States because the U.S. rule does not apply unless the work is both made and sold in the United States.[115] Consequently, the copyright owner is protected only against pirate copies; copies which are legally produced and sold under license in any other state of the European Community[116] must be admitted to the United Kingdom. The copyright owner presumably could apply the U.K. statute to an article imported from a state outside of the European Community, but this would be of little avail because the article could be imported first to another EC state (where the U.K. statute would not apply) and then imported into the United Kingdom under the EC rule. The U.K. copyright holder thus has little protection against gray market imports. A U.K. buyer under the CISG would be liable to a claim of copyright infringement, and thus a claim would arise under Article 42 only if the goods were pirate copies, or if the import were imported directly to the United Kingdom from a non-EC member state.

3. Patents

U.K. law is less protective of patent owners than of copyright owners; a patent holder exhausts his rights when he sells or authorizes the sale of the patented item, which may thereafter be imported into the United Kingdom without infringing the

112. Copyright, Designs, and Patents Act, 1988 § 22.

113. *Id.; see also* A. Hoolahan et al., *Copyright*, *in* 9 HALSBURY'S LAWS OF ENGLAND para. 920 (1974).

114. Case 78/70 Deutsch Grammophon Gesellschaft v. Metro-SB-Grossmarkte, E.C.R. 487 (1971); *see also* Vaughn, *supra* note 67, para. 19-365. The rule may be different when an intangible, such as the right to exhibit a motion picture, is at issue. That would not involve the sale of a good, however, and is thus outside the concern of the CISG.

115. *See* NIMMER, *supra* note 77, § 8.12[B][6].

116. These situations would be Cases 2 and 3 under K-Mart.

patent.[117] This is a strict version of the first sale doctrine. The same general rule exists in the European Community; once a product is sold to a third party by the patentee or his licensee in any member state, it may be imported freely into any other member state.[118] Because the concern in the European Community is the effect of patents on competition, however, the rules are complex and beyond the scope of this Article. Certain licensing agreements which would restrict competition between a licensor and licensee are allowed under a "block exemption,"[119] and the specific terms in patent licenses may make a crucial difference.[120] A U.K. buyer of non-pirated patented goods, however, is protected by the U.K. rule without having to rely on the EC doctrines.[121] Little danger exists that such a buyer would be subject to a third-party claim based on patent rights. Thus, the seller would not be liable under Article 42.

The United Kingdom recently established a new "design right" which has some aspects of both a patent and a copyright.[122] It protects the specific design of an article, but is like a copyright because it is unregistered and does not require an examination or a showing of novelty. The statute gives the design right owner protection against imports that infringe the design right in the case of an unauthorized or pirate copy, and also in the case of an authorized copy that is imported in violation of a licensing agreement.[123] This appears to be an attempt to legislate gray market protection based on the design right, although the statute explicitly subjects the new protection to overriding EC law.[124] Because there is no reason to believe the ECJ would view the design right any differently from other aspects of intellectual property regarding its effects on trade, licensing agree-

117. Betts v. Willmott, 6 Ch. App. 239 (1871); *see* T. White & Mary Vitoria, *Patents and Inventions*, 35 HALSBURY'S LAWS OF ENGLAND para. 584, at 326.

118. Case 15/74 Centrafarm BV v. Sterling Drug, E.C.R. 1147, 1162, 1168 (1974); *see* Vaughn, *supra* note 67, §§ 19-338 at 1068. Centrafarm involved a patentee who licensed the patent rights in another country. The licensee sold to a third party who then resold the goods in the patentee's country.

119. *Id.* §§ 19-339 to 19-342.

120. *Id.* §§ 19-343 to 19-354. Broadly speaking, the EC rule is similar to the U.S. rule: there is no protection from gray market competition by third parties, but bilateral licenses may restrict competition between the parties.

121. This appears to be true whether the buyer buys from a third party or from a licensee selling outside of her license. In the latter case the licensor might have a case against the seller directly, but not against the buyer. Article 42 would not apply.

122. Copyright, Design and Patents Act, 1988 §§ 227, 228.

123. *Id.*

124. *Id.* § 228(5).

ments restricting gray market imports are likely to be struck down absent special circumstances.[125] Thus, it seems unlikely that the U.K. design right statute could give rise to a third-party claim against a buyer of goods manufactured and sold in another EC state under license, even if the license explicitly forbade such imports.

In summary, while U.K. law appears to grant substantial gray market protection in trademark and copyright cases, the overriding EC rules prevent that protection from being effective in any case in which a product is lawfully sold to a third party in any member state. Once sold, the product can move freely to any other state. As in U.S. law, certain bilateral license agreements restricting competition between the parties can be enforced, but these cases would involve suits directly against the licensee-seller, to which CISG Article 42 would be irrelevant.

III. CONCLUSION

From this summary of intellectual property protection in the United States, United Kingdom and European Community, it is clear that the extent to which a particular sale of goods may raise the possibility of third-party claims based on IPRs is a matter of complicated national law, and increasingly of supranational law as well. The extent of the liability, if any, would depend on the specific nature of the goods; the specific provision under national law for the patent, copyright, trademark, or other right asserted; the nature of any licensing or other agreements involved; and the way all these factors interact with antitrust and unfair competition doctrines. Although the general rules with respect to gray market constraints in the United States, United Kingdom and European Community are not difficult to describe, many situations could raise IPR issues other than gray market constraints.

This general situation supports the earlier argument that Article 42 should not be interpreted to place a duty on the seller to carefully research the possible IPR implications of a sale. It should be sufficient to require the seller to be reasonably aware

125. In a case involving "plant breeder's rights" akin to patents, the ECJ held a licensing agreement that restricted gray market imports inconsistent with EC law in the face of arguments that exclusive licensing arrangements should be justified by the fact the hybrid seeds involved had to be specially tailored for specific regions. Case 258/78 Nungesser v. Commission E.C.R. 2015, 2060-71 (1982).

of IPR claims based on information the seller possesses, and to tell the buyer what the seller knows about the situation.

The seller, however, cannot safely assume that a court or other tribunal would in fact interpret Article 42 in this way. To protect the seller, the contract should include a term which makes clear what liability, if any, the seller is willing to accept under Article 42, and, citing Article 6,[126] that any other such liability is disclaimed.

126. *See supra* note 19.