

## All-Party Parliamentary Group for Intellectual Property Note for Virtual Meeting on the UK's Exhaustion Regime

**Date:** Tuesday 14<sup>th</sup> September 2021

**Time:** 17:00-18:00

**Attendees:** Pete Wishart MP, Ruth Jones MP, Baroness Neville-Rolfe, Lord Clement-Jones, Lord Foster of Bath and The Earl of Devon.

### **Issues covered:**

- The impact of an international exhaustion regime on publishing and other IP-rich industries
- The need for the UK Government to consider the concerns of these IP-rich industries as it makes a decision on the UK's future regime
- The process by which any change to the exhaustion regime will be implemented, and a potential timeline for any change

### **Speakers:**

- **Isobel Dixon**, MD and Head of Books, Blake Friedmann Literary Agency
- **Dr Bobby Mukherjee**, Chief Counsel – Intellectual Property & Technology Law, BAE Systems PLC (speaking as a representative of the IP Federation)
- **Neil Sharpley**, Chair, Home Office and Ministry of Justice Policy Units, Federation of Small Businesses
- **John Noble**, Director, British Brands Group
- **Gavin Terry**, Lead Officer for Intellectual Property, The Chartered Trading Standards Institute
- **Dan Guthrie**, Director General of the Alliance for Intellectual Property - Provided the Group's officers and members with an update on key developments in IP policy

### **Context of the meeting**

This meeting came shortly after the closure of Intellectual Property Office's (IPO) consultation on the UK's future exhaustion of IP rights regime.

Following the UK's exit from the EU, the UK Government has an opportunity to decide its future regime for the exhaustion of intellectual property rights. The regime that the UK opts for is a matter that is of critical importance for IP rich industries, as any future decision taken by the Government has the potential to significantly disrupt the ability of UK businesses to export their world leading products.

The importance of the decision on which exhaustion regime the Government chooses cannot be underestimated. Although a technical area of policy, it will have real-life consequences for businesses, consumers and regulatory authorities across the UK. Exhaustion regimes have the greatest impact on export-driven UK sectors, as it underpins their ability to determine when, how and what goods to sell in international markets and at what price. UK IP-rich industries are highly successful at exporting, with, for example, the UK book sector deriving 60% of its income from exports.

## What is exhaustion?

The exhaustion of intellectual property rights relates to when IP rights owners lose the right to control the geographical resale of their protected goods. Once a good is put on sale by the intellectual property right (IPR) owner they maintain control over the subsequent re-sale of the product. The geographical limit of that control, or where they lose those rights, is known as the 'exhaustion' of those rights. In other words, exhaustion refers to the **moment** and **geographical boundary where the IPR owner loses the resale right on their product**.

## How does it work?

**Parallel trade is the cross-border sale of goods by traders** (outside of the rights holder's distribution system), **without the rights holder's consent**. Therefore, parallel trade provides importers with the ability, to buy goods in one country at a relatively low price and subsequently resell them in another country where the price is higher. However, IPR owners need to set different prices in different markets for many reasons, including the cost of production and distribution in different geographic areas, for marketing reasons, and to reflect different consumer spending capacity in different countries.

Exhaustion regimes provide IPR owners with the ability to maintain **some control over pricing** in different territories. This means companies have some certainty of the returns they are likely to recoup on a global basis and can ensure they are able to **recover their investment**.

If there is **unrestricted parallel trade**, producers have no certainty on the income they are likely to receive from the sale of their products in different markets because parallel imports could undermine the sales they're trying to make in higher price point markets. Without the certainty of income, budgeting forecasts are much more difficult to make, meaning they are less likely to reinvest in their business, which would have a significant impact on innovation.

For example, if a product is priced at a lower price in India, to reflect the lower spending power of the Indian public, that product could then be exported anywhere in the world, undermining pricing in other territories and ultimately driving down the income that can be recouped on a global basis for that product. It also means that the Indian public don't have access to that lower priced product because it is simply re-exported to other higher income per capita countries.

## Types of exhaustion regime

There are three types of exhaustion regime that countries can choose to adopt, and this has a **considerable impact on the international trade of goods**.

### Regional

The UK was part of a regional regime through its membership of the European Economic Area (EEA). A regional exhaustion regime (EEA-wide exhaustion) allows parallel imports between the countries which are member of the regional agreement, but not the parallel trade coming from other states. Therefore, once a product had been exported from the UK to France, it could then be circulated freely within the EEA area, without the permission of the rightsholder. However, a product could not be exported from the UK to India and then be re-imported into the EEA area.

### National

Under a national exhaustion regime, once a product is first sold in the UK with approval from the IPR holder, the rights holder cannot stop the product being resold within the UK. However, IPR holders are able to prevent the resale of any goods that are placed on the market outside of the UK, thus restricting parallel imports of products from another country.

### **International**

Contrastingly, under international exhaustion, once the IPR owner (or another with approval from the IPR holder) puts the goods on the market outside of the UK, the rights holder loses any right to control how and where those products are subsequently resold, meaning they cannot prevent parallel imports from abroad.

**The APPG heard from a range of expert speakers representing different UK industries. They provided a range of case studies to the Group on the effect a new exhaustion regime could have on their sectors and below is a summary of the key points made:**

### **Case Study: Impact of an international exhaustion regime to the publishing industry**

Publishing is worth £6.4 billion to the UK economy and supports 70,000 UK jobs. The UK is the world's biggest exporter of books, with publishers earning 58% of their income from sending their books abroad. As a net exporter of books, the UK is in a unique position than other countries in the European Union and rest of the world. As such, an international exhaustion regime risks costing the UK economy a significant amount. The Publishers' Association has estimated that an international exhaustion regime would cost the publishing industry £2.2 billion a year, with authors losing a further £506 million.

The publishing and wider book industry is very concerned about the risk posed by an international exhaustion regime. Authors in particular would be hit hardest by this change. The Association of Authors' Agents (AAA) has predicted that authors could lose more than 65% of their income, especially fiction and children's writers. Some of their modelling shows a 70-85% loss for certain titles. In addition, authors face a further cut in their income from their export royalties, which are often half the rates offered in the UK. Cheaper formatted overseas copies made in the UK would return to the UK from abroad in a mass substitution of local sales. Authors would not earn anything on these returning sales, which would be considered as secondhand sales.

Research has shown that the majority of authors find their incomes under pressure, a majority which has been increased by COVID-19. A 2019 Authors' Licensing & Collecting Society study revealed that the average income for professional authors was £10,500.<sup>1</sup> Further cuts to this income would mean fewer and fewer people will be able to afford to be authors and have a career as an author.

A trade alliance comprising the Publishers Association, Society of Authors, Association of Authors' Agents and the Authors' Licensing & Collecting Society has launched the "Save Our Books" campaign in response to mobilise support against the international exhaustion option by pointing out the serious unintended consequences should it be adopted.<sup>2</sup> As a result of this campaigning, there have been over 3000 signatories to an open letter to the Secretary of State and 4,500 people have written to their MPs expressing their concern.

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<sup>1</sup> [RSL-A-Room-of-My-Own-Report-19-June-2019.pdf \(d16dqzv7ay57st.cloudfront.net\)](#)

<sup>2</sup> <https://www.saveourbooks.org.uk/>

From a consumer perspective, readers would lose out on choice. The race to the bottom international exhaustion prompts would mean a reduction in the number of books or authors that are published. Any price differential would be eliminated by the intermediaries and the internet providers that sell them.

### **Case Study: Impact of an international exhaustion regime on SMEs**

Small businesses account for 52% of private business turnover and employ 61% of the private sector workforce. The Federation of Small Businesses represents 60,000 of these SMEs. These businesses make significant contributions to the UK economy in terms of taxation, and so their concerns should be shared not only by business leaders but also by the wider economy.

Small and Medium-sized enterprises face competition on two fronts, both from international businesses but also larger UK companies, which are better resourced and equipped to challenge IP-infringing products. Smaller businesses do not have the capacity to hire legal teams to track down piracy and copied work. As such, SMEs rely on a clear IP rights system to protect all creatives. Such a system is essential to their business survival. National exhaustion is the option that is most consistent with a strong IP regime and which therefore benefits consumers and the economy. Such a system allows IP rights holders to ensure that only good-quality products are supplied to UK consumers.

### **Case Study: Impact of an international exhaustion regime on pricing and consumers**

An argument for international exhaustion regime is that it will lower the prices for the consumer. However, this argument is narrow and misleading. Firstly, price differentials exist across the UK and any price differential is not a signal of market failure. The Competition Commission previously studied the price differences between the UK and Europe, concluding that UK prices tend to be more expensive than European countries, but that this is largely as a result of exchange rates.

In an international regime, products may be able to be brought into the UK at a discounted price but there lacks evidence as to how much cheaper they would be and whether the consumer would see this decrease. These foreign products could also return to the UK at the same price, as 10% of the British Brands Group's membership reported, or even be sold more expensively. A report commissioned by the European Commission in 2000 found that a change in regime will have a "barely perceptible" reduction in pricing for the consumer, estimated at between 0 and 2%.<sup>3</sup> An international regime does not therefore guarantee lower prices. Any price advantage would need to be passed on through the supply chain to the customer, which is unlikely in an economy where companies charge what the market can bear.

Any reduction in price is not always in the consumer's best interest. Products brought back in to the UK through an international exhaustion regime can vary widely. Most companies change the formulation of their products depending on the market tastes and on regulatory differences in the various countries.

In addition, international exhaustion makes it difficult for consumers to tell the difference between illegal and legal products. The UK regulatory framework adopts a presumption of compliance, and an international exhaustion regime would make it impossible to ensure this regulatory compliance.

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<sup>3</sup> [EUR-Lex - 52001IE0042 - EN \(europa.eu\)](https://eur-lex.europa.eu/lexuris/ui/entry.do?entryId=52001IE0042)

## Conclusion

Overall, an international exhaustion regime would be damaging to some of the UK's largest industries. The Group heard how authors' livelihoods are at risk from cuts to their income, while consumers would be faced with less choice. Consumers would also be at risk of interacting with illegal products or products that do not comply with Britain's rigorous safety standards. The increased risk would not even be reflected in pricing, leaving consumers paying the same amount for sub-standard products.

## Recommendation

- Ensure that the Government understands the significant impact that an international regime would have on a variety of UK industries.

## Next Steps

- The IPO's consultation has now closed, with over 160 responses submitted. The IPO is now considering the legal questions raised surrounding the Northern Irish Protocol and will be advising Ministers in the coming months. Any change to the framework will be implemented through legislation and followed by an extensive implementation period.
- While the Group waits for the Government's response to the consultation and decision on the exhaustion framework, it will write to the IP Minister to outline these issues.

## For more information please contact:

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