CHAPTER 8

General Agreement on Trade in Services and Its Interface with Patent Exhaustion

8.1 GATS and Patent Exhaustion

The GATS Agreement lays down multilateral rules under the WTO system to govern trade in services. The main aim of this agreement being removal of barriers to trade in services like the removal of trade barriers in trade in goods. Here the difference is that unlike trade in goods where the item traded has a physical definition, services are, '*non-visible, non-storable exchanges of activities requiring simultaneous presence of buyer and seller*'.[529] In general the GATS is the only agreement that deals with different types of issues related to trade in services but it does not cover inter-disciplinary issues within the WTO system, e.g. Service and IPRs. Trade in services is classically addressed distinct from trade in goods and the value-added contribution of services that often come with the goods are not accounted for. In case of technology products that are patent protected, after-sales service although does not establish any direct interface between TRIPS and GATS, the latter's relevance for patents cannot be undermined. E.g. In cases of patented products, they might come with exclusive service attached to the product and raise question as to whether the service would need to be considered separately and severally. Further, in some products like aircraft engines, the patented products are leased under service agreements hence the link between the products and adjoined services cannot be separated.

Protection accorded to IP (e.g. an invention) is in respect of the concerned goods, whereby the goods are protected as per requirements provided by the TRIPS Agreement. In a hypothetical case where a patent holder provides after sales services, if national exhaustion is followed, it is usually argued that since the service is tied to the patented product, no person other than the authorised person can undertake such repairs. It might be argued that a manufacturing process could be qualified as a service and as a result protected by the patent. However, this is not the case since under the TRIPS Agreement, an

529 Dunkley Graham, "At whose service? Services and intellectual property in the Uruguay Round", in "The Free Trade Adventure", pgs. 176, 177, 1997.

infringement of the process patent will extend the effect of the infringement to the products and not to the process on its own, thus not to the service. As such an argument that the service is tied to the patent hence protected, would not hold ground.

A point of reference is a Scottish case, *United Wire Ltd. v Screen Repair Services* (*Scotland*) *and others*[530] where the House of Lords in the UK decided that a patent holder could not restrict a third party to conduct repair on a patented product. In this case the court however provided some restrictions too, it stated that if such repair increases the life of the patented product in a manner that the product becomes equivalent to a new product (like the initial patented product), such repair service would result in infringement of the patent. Thus, such a case would fall more under the purview of TRIPS rather than GATS Agreement. If we consider a case where the service is protected by trade mark or service mark, parallel trade in such services would be addressed under TRIPS and/or GATT instead of GATS since the latter does not provide any guidelines related to IPRs. In such circumstances, if international exhaustion is followed, there is no confusion as to rendering of such service and its protection, since any third party would be eligible to undertake such repairs.

In fact, there is a wide range of possibility of parallel trade in services since very often services provided by one organisation is franchised in another country by way of license agreement. In such a case, the licensor might raise the same issue as in patented products. There might be a possibility of competition from its own licensee, which should likely be considered as a problem by the licensor but that is not the case. Often patent owners claim that parallel trade should not be promoted since the products are tied with services and the parallel trader would not be able to provide such service (in other words, only authorised dealers would be able to provide such after sales service). However, in cases where the patented products are sold in the market without a guarantee of after sales services, it should not be possible for the patent holder to impose such restrictions. For example, in the growing trade through electronic media where the product is mailed to the customer, sometimes international service is not included. Further in countries where patents are provided for business methods and computer programmes which are transported from one country to another via internet, servicing of the products could be interpreted an infringement if national exhaustion is followed.

530 Ibid at 140.

8.2 Article II and Article XVII in GATS and Its Impact on Patent Exhaustion

The MFN and NT not only play an important role in GATT but also in GATS. As we have already noticed, GATS aim at liberalising cross-border services and as such the MFN obligation covers not only those who have scheduled market commitments but also those that are not covered. On the other hand, NT in GATS is similar to that of GATT in its treatment of national and foreign service providers but applies to those who have made market access commitments.

In today's global value chain, it is increasingly difficult to de-link goods and services interfaced with IPRs. With an obvious intent to reduce cost and enhance profit, firms are trying to maximise efficiencies by dispersing production to different countries. For example, handheld mobile computing devices in which the design and hardware of the chip (where the significant IP value reside) may be done in one country while the chip manufactured by them in fabless manner in some other country where cost of production is low.[531] Further this chip will go into the device where the battery may be manufactured in another third country while the casing in another and screen in another country and finally sold and serviced under completely a different brand name.

In such scenario where production has become in a way '*factoryless*', given that a single factory in a single country cannot be attributed to the manufacture of a particular product, restricting after sales service exclusively to authorised distributers could attract scrutiny under GATS. Parallel imports manufactured under same patent held in different jurisdiction is automatically getting linked to the related service attached to the product and with restrictions imposed would undermine rights accrued under the WTO member's GATS schedules.

Historically, the GATS had not been included in the 1947 GATT however with increasing trade in services it was needed to be included. Hence a negotiating item making lateral entry had other issues, it had to balance between liberalisation of services at the multilateral platform and at the same time accommodate the existing discriminatory trade practices resulting in certain dissimilarity with GATT.[532] For this reason although the GATS MFN follows the

531 See, Fabless manufacturing … https://www.investopedia.com/ask/answers/050615/what-are-fabless-chip-makers-and-why-are-they-important-semiconductor-market.asp.

532 Mattoo Aaditya, "MFN and the GATS", in Cottier Thomas, Mavroidis Petros (eds.), "Regulatory Barriers and the Principle of Non-Discrimination", in World Trade Law, Ann Arbor 2000, The University of Michigen Press. Based on the paper presented at the World Trade Conference on "Most-Favoured Nation (MFN): Past and Present", at Neuchatel,

GATT MFN in its drafting language, it curves out not only general exceptions but specific ones for RTAs. *Article II* prohibits discrimination between like services and service providers from different WTO members.

It states,

1. With respect to any measures covered by this Agreement, each Member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favourable than that it accords to like services and service suppliers of any other country.
2. A Member may maintain a measure in consistent with paragraph 1 provided that such a measure is listed in, and meets the conditions of, the Annex on Article II Exemptions.
3. The provisions of this Agreement shall not be so construed as to prevent any Member from conferring or according advantages to adjacent countries in order to facilitate exchanges limited to contiguous frontier zones of services that are both locally produced and consumed.

A careful study of this Article enumerated above will show that the MFN requirements are set through a three-prone test as to whether, I) the concerned measure is a '*covered measure*' under GATS; II) the services or service suppliers qualify as '*like services*' and/or '*like service suppliers*'; and III) the member accords '*less favourable treatment*' to the services and service suppliers of another member. Hence, WTO members are mandated to treat all like services and service suppliers of the members without discrimination. This means the Article prohibits a WTO member to discriminate services and service suppliers based on nationality, national origin, or destination of a product.[533]

Unlike in GATT where there is only '*like products*', in GATS the concept of '*like services*' and '*like service suppliers*' need to be considered and hence to determine '*likeness*', it is important to distinguish modes from methods. This is important since services may be supplied by different methods while the GATS commitment might be restricted to only certain modes of supply. The two questions pertinent to determining '*likeness*' is whether it can exist

28–29 August, 1998. Available at, https://www.iatp.org/sites/default/files/MFN_and_the_GATS.htm.

533 Milhem Moawiah, "Most-Favoured-Nations (MFN) and National Treatment (NT) principles under GATT and GATS", Brunel University Law School London, 2013. Available at, https://www.academia.edu/5518155/Most-Favoured-Nations_MFN_and_National_Treatment_NT_principles_under_GATT_and_GATS.

across *modes of service supply* and across *methods of service supply* (*emphasis added*). Now if we address '*likeness*' and relate it to NT, we will need to compare between foreign service that is restricted under the four modes as per GATS *Article I:2* and the service provided domestically.[534]

If the exhaustion of patents is seen through the prism of GATS *Article II*, one would need to examine whether national and regional examination would pass the test of '*covered measure*' or MFN treatment was accorded to '*like services or service suppliers*'. Given that any government '*measure*' is considered as '*covered measure*', a hypothetical question arises as to whether the after-sales service of a patented product restricted only to products sold through authorised distributors can be considered a covered measure. Similarly, whether refusal to provide after-sales service to parallel imports by the manufacturer or authorised distributors of patented products would violate MFN. It is also to be seen when a member discriminates between patented products and their parallel imports restriction on after-sales services, whether the parallel imports that are refused service by the manufacturer or authorised distributors be considered '*less favourable treatment*'.

It is interesting to note that the NT requirement in GATS is subject to the member's market access commitments made in the '*Schedules of Commitment*'. In other words, there are three elements in these commitments, i.e. I) the general principles that affect the services at the time its applied; II) specific schedule of commitments; III) sector-specific annexes as to application of NT. Considering the fact that the GATS is focused on services, it does not specifically address tariffs and quantitative measures.

Article XVII elaborates NT,

1. In the sectors inscribed in its Schedule, and subject to any conditions and qualifications set out therein, each Member shall accord to services and service suppliers of any other Member, in respect of all measures affecting the supply of services, treatment no less favourable than that it accords to its own like services and service suppliers.
2. A Member may meet the requirement of paragraph 1 by according to services and service suppliers of any other Member, either formally identical treatment or formally different treatment to that it accords to its own like services and service suppliers.

534 Diebold F. Nicholas, "Non-Discrimination in International Trade in Services 'Likeness' in WTO/GATS", Cambridge University Press, pgs. 186–219, 2010.

3. Formally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favour of services or service suppliers of the Member compared to like services or service suppliers of any other Member.

Interpretation of MFN and NT in context of the GATS can be read in the *EC – Bananas III* case decided by the AB after it went on appeal from the Panel.[535] This is one of the initial GATS cases that addressed both MFN and NT while examining the measure affecting trade in services. The core issue under GATS was whether EC license allocation procedures for the importation of bananas in the EC. Ecuador, Guatemala, Honduras, Mexico and United States complained that EC Regulation 404/93 for importation, distribution and sale of bananas accorded de-facto preferential treatment to those of EC origin. It can be noticed that although EC licensing regulations did not discriminate between banana distributors of EC-origin and non-EC origin, the fact that they had separate operator categories for different service suppliers raised an issue.[536]

On examination of the design, architecture and revealing structure of the measure at issue, the panel found that the EC's schedule of commitments assured favourable treatment under GATS *Article II and XVII* to different '*wholesale trade services*' (both direct and subordinate). It was found that the rules were drafted in a manner that it altered the conditions against the complainants who were foreign-owned or controlled entities. As a result, the complainant's suppliers of wholesale services were de-facto granted less favourable treatment than the EC and ACP[537] suppliers. Further, the '*newcomer*' licenses with '*single-pot*' license rules were also de-facto discriminatory and in violation of *Article XVII*.[538] The AB upheld the Panel's finding that the EC's measures were not consistent with *Articles II* and *XVII*, i.e. they were in violation of MFN and NT.

From the *EC – Bananas III* case even when the license allocation rules of the EC were not directly based on nationality, ownership, or control of the distributor, apparently not discriminatory, it was found otherwise. The AB concurred with the Panel decision that complainant's suppliers of wholesale services

535 Ibid at 442.

536 Ortino Frederico, "The principle of non-discrimination and its exception in GATS: Selected legal issues", paper presented at the conference, "Conflict and Crises – The WTO after Hong Kong", Vienna, pg. 6, 8, 18, (3–20), 24–25 April 2006. Available at, SSRN electronic journal, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=979481.

537 ACP – African Caribbean and Pacific group of countries.

538 See Panel Reports at, https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds27_e.htm.

were de-facto granted less favourable treatment. In a hypothetical case of international exhaustion, if the same reasoning is applied, parallel imports could be deemed to have been meted with less favourable treatment vis-à-vis services for the patented product. In case of patented products manufactured in the country, after-sales service under warranty is provided while the parallel imports manufactured by the patent licensee outside the country is denied warranty and after-sales service. Like the *EC – Bananas III* case, although there is no direct discrimination based on nationalities, less favourable treatment is accorded to the imported from outside the nation.

8.3 Exceptions to Most Favoured Nation and National Treatment and Its Impact on Patent Exhaustion under Article V and Article XIV

The general exceptions provided in *Article XIV* GATS serve similar purpose like that of *Article XX* GATT 1994 where WTO members can justify non-adherence to GATS compliance on certain grounds. In absence of *Article XIV*, some of the actions taken by the members on number of non-trade policy issues would have been clearly considered trade distortive and inconsistent with the WTO regulations at large. In essence the objective to include such exceptions is to maintain a balance between trade liberalisation on one hand and important policy goals of the member state on the other.

It is in such background that *Article XIV* states,

> subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where like conditions prevail, or a disguised restriction on trade in services, nothing in this Agreement shall be construed to prevent the adoption or enforcement by any Member or measures:
> (a) necessary to protect public morals or to maintain public order;[539]
> (b) necessary to protect human, animal or plant life or health;
> (c) necessary to secure compliance with laws or regulations which are not inconsistent with the provisions of this Agreement including those relating to:

539 Footnote 5 to *Article XIV* (*c*) states, "*The public order exception may be invoked only where a genuine and sufficiently serious threat is posed to one of the fundamentals interests of society*".

(i) the prevention of deceptive and fraudulent practices or to deal with the effects of a default on services contracts;
(ii) the protection of the privacy of individuals in relation to the processing and dissemination of personal data and the protection of confidentiality of individual records and accounts;
(iii) safety;

(d) inconsistent with Article XVII, provided that the difference in treatment is aimed at ensuring the equitable or effective imposition or collection of direct taxes in respect of services or service suppliers of other Members;[540]

(e) inconsistent with Article II, provided that the difference in treatment is the result of an agreement on the avoidance of double taxation or provisions on the avoidance of double taxation in any other international agreement or arrangement by which the Member is bound.

From the language of the text in *Article XIV*, it is understood that the exceptions are broad hence their applications are not meant to be uniform, instead it would vary from one member's requirement to the other. This is interesting since WTO regulations seek to introduce uniformity in trade regulations of member countries through a common framework with an intent to remove trade barriers. However, GATS exhibit relatively more flexibility than GATT and

540 Footnote 6 to *Article XIV* (*d*) states, "*Measures that are aimed at ensuring the equitable or effective imposition or collection of direct taxes include measures taken by a Member under its taxation system which:* (*i*) *apply to non-resident service suppliers in recognition of the fact that the tax obligation of non-residents is determined with respect to taxable items sourced or located in the Member's territory; or* (*ii*) *apply to non-residents in order to ensure the imposition or collection of taxes in the Member's territory; or* (*iii*) *apply to non-residents or residents in order to prevent the avoidance or evasion of taxes, including compliance measures; or* (*iv*) *apply to consumers of services supplied in or from the territory of another Member in order to ensure the imposition or collection of taxes on such consumers derived from sources in the Member's territory; or* (*v*) *distinguish service suppliers subject to tax on worldwide taxable items from other service suppliers, in recognition of the difference in the nature of the tax base between them; or* (*vi*) *determine, allocate or apportion income, profit, gain, loss, deduction or credit of resident persons or branches, or between related persons or branches of the same person, in order to safeguard the Member's tax base. Tax terms or concepts in paragraph* (*d*) *of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure.*"

TRIPS in this respect, hence both market access under MFN and NT obligations are comparatively less stringent.[541]

The '*Security exceptions*' in *Article XIV bis*, by nature of exceptions is like the general exceptions but can be evoked essentially to justify security situations that the WTO members may face. This, although similar in nature, makes it qualitatively different to the general exceptions in two distinctive manner a) the exception does not have any '*chapeau*' that means it is not subject to any arbitrary or unjustifiable discrimination; and b) members need to assess their security and consider that the measure engages their essential security interests. Hence, this would enable a member to evoke security exception if the circumstances fell into any of the general scenarios mentioned in *Article XIV bis*.[542]

Article XIV bis states,

1. Nothing in this Agreement shall be construed:
   (a) to require any Member to furnish any information, the disclosure of which it considers contrary to its essential security interests; or
   (b) to prevent any Member from taking any action which it considers necessary for the protection of its essential security interests:
      (I) relating to the supply of services as carried out directly or indirectly for the purpose of provisioning a military establishment;
      (II) relating to fissionable and fusionable materials or the materials from which they are derived;
      (III) taken in time of war or other emergency in international relations, or
   (c) to prevent any Member from taking any action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security.

541 Cottier Thomas, Delimatsis Panagiotis and Diebold Nicolas, "Article XIV GATS: General Exceptions", in Wolfrum Ruediger, Stoll Peter-Tobias and Feinaugle Clemens (eds.) "Max Planck Commentaries on World Trade Law, WTO – Trade in Services", Vol 6, Martinus Nijhoff Publishers, pgs. 287–328, 2008. Available at, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1280215.

542 Ayres Glyn and Mitchell Andrew, "General and Security Exceptions under the GATT 1994 and the GATS", in Carr Indira, Bhuiyan Jahid and Alam Shawkat (eds.), "International Trade Law and WTO", Federation Press, pg. 266, 2012. Available at, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1951549.

2. The Council for Trade in Services shall be informed to the fullest extent possible of measures taken under paragraphs 1(b) and (c) and of their termination.

The security exceptions as provided in *Article XIV bis*, clearly pans very widely and although have sparsely invoked, might attract WTO members given the increasing security concerns globally, including cyber espionage threats of varied nature. At the same time given its breadth, possibilities of protectionism disguised under security exception cannot be ruled out. In such scenario countries have already started opting for regulatory requirements in their local legislation like mandatory data localisation, etc. that, outside the security exception would have clearly violated the MFN and or NT obligations.

The recent *Russia – Measures Concerning Traffic in Transit* (*Russia –Transit Measures*) case under *Article XXI*(*b*) GATT security exception, decided by the Panel although deliberates on GATT, is worth noting given that the ramifications on similar situation under GATS cannot be ruled out. In this case dealing with Ukraine's complaint against Russia's transit restrictions, interpretation of '*essential security threat*' is important. In this specific case, Russian measures mandated certain travel routes from Ukraine to Kazakhstan and Kyrgyzstan only through the Belarus-Russia border, subject to certain conditions and imposed certain transit bans directly and indirectly. Ukraine alleged violation of *Articles V* and *X* of GATT[543] and Russia's related commitment to its WTO Accession Protocol but Russia claimed, '*essential security interest*' defence under *Article XXI*(*b*) GATT.[544] The Panel opined that the invocation of the exception is not '*self-judging*' and justiciable, hence to be scrutinized by the WTO DSB. It then let down the two-prong legal test under GATT

Article XXI (b):

I. objective determination whether the requirements under Article XXI(b) under the concerned sub-paragraphs are met;
II. once the requirements are met, were they genuinely taken for the member's essential security interest in good faith or for some other unrelated reason. It must be noted that the Panel distinguished between 'security interests' as broad and 'essential security interests'

543 GATT *Article V*: https://www.wto.org/english/res_e/publications_e/ai17_e/gatt1994_art5_gatt47.pdf; GATT *Article X*: https://www.wto.org/english/res_e/publications_e/ai17_e/gatt1994_art10_gatt47.pdf.

544 *Russia – Measures Concerning Traffic in Transit*, Panel Report WT/DS512/R, 5 April 2019. Available at, https://www.wto.org/english/tratop_e/dispu_e/512r_e.pdf.

> as narrow and more specific, e.g. to protect the people, internal law and order and any external threats. However, the Panel opined that the member would be free to define its 'essential security interests' although would still be required to demonstrate the essential security interests and how the measure would enable protection as well as whether this was necessary.

Considering that Ukraine and Russia were close to '*hard core*' armed conflict at that time with an emergency-like situation in 2014, the travel transit restrictions were not unrelated and conformed to Russia declaring them as '*essential security interests*', hence the measures qualified under GATT *Article XXI*(*b*) scrutiny.

The case has no direct relation with IPRs and it is difficult to construe how the general exceptions under *GATS Article XIV* can apply in case of parallel imports of patented goods tied with after-sales service. Drawing an analogy with the *Russia – Transit Measures* case, let us consider a hypothetical case – A WTO member which follows international exhaustion restricts parallel imports of telecommunication equipment from a particular country discriminating with similar parallel imports from other WTO countries, apparently violation of both NT and MFN obligations. The importing country claims security exceptions under *Article XIV bis and GATT Article XXI*(*b*) and establishes that the parallel imports of the telecom equipment which enables voice and data telephony services, had been embedded with malware and spyware for cyber espionage. After *Russia – Transit Measures* case it is difficult how the '*essential security interests*' would not meet in this case.