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Intellectual Property and Intra-Community Trade

Andreas Reindl*

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Abstract

This Article will use recently decided intellectual property cases and other recent developments in European Community competition law to critically discuss the European Community's traditional and strict pro-free trade approach in intellectual property cases. It will focus in particular on issues relating to the territorial nature of intellectual property rights. Part I of this Article examines the Court's free trade approach in free movement cases involving patent rights. Part II explores patent rights in the context of technology Licensing Agreements, in particular in light of recent antitrust developments concerning vertical restraints. Part III discusses trademark issues. It first considers free movement rules and concludes with a brief discussion of trademark Licensing Agreements and antitrust law.

INTELLECTUAL PROPERTY AND INTRA-COMMUNITY TRADE

*Andreas Reindl**

INTRODUCTION

The role of intellectual property rights in the European Community has been the subject of a passionate discussion since the early days of the European Community. The predominant issue has been the territorial nature of intellectual property rights. Community law has traditionally perceived Member State created intellectual property rights as a threat to market integration. Free movement of goods rules and competition law are designed primarily to limit the market partitioning potential of intellectual property rights. Other aspects of intellectual property such as their contribution to innovation or marketing efforts have received less attention.

The single-minded focus on the territorial nature of Member State created intellectual property rights in free movement of goods cases has resulted in a set of intellectual property specific rules. The European Court of Justice ("Court") developed the concepts of "subject matter" and "essential function" to decide whether the enforcement of intellectual property rights is permissible under Community law.¹ Those tests are less flexible than the rules in other cases where the Court applies exceptions from Article 36 of the Treaty Establishing the European Com-

* Research Institute for European Affairs, University of Economics, Vienna. A version of this Article will appear in 1997 FORDHAM CORP. L. INST. (Barry Hawk ed., 1997). Copyright © Transnational Juris Publications, Inc., 1997.

1. With minor variations, the European Court of Justice ("Court") has defined the "subject matter" of intellectual property rights as the holder's right to put protected products on the market for the first time. Member State laws that allow the right holder to block parallel imports are, therefore, almost automatically found incompatible with Community law. The variations in the definition of the "essential function" of intellectual property rights are more significant among various intellectual property rights. The "essential function" refers to the purpose or role of an intellectual property right. Free movement rules may not undermine what the Court has defined as an intellectual property right's essential function. See, e.g., Centrafarm BV and De Peijper v. Sterling Drug Inc., Case 15/74, [1974] E.C.R. 1147, [1974] 2 C.M.L.R. 481; SA CNL-SUCAL NV v. HAG GF AG, Case C-10/89, [1990] E.C.R. I-3711, [1990] 3 C.M.L.R. 571 [hereinafter HAG II].

munity ("EC Treaty")² with a more nuanced policy analysis that focuses on the legitimacy of Member State policies and the proportionality of import restrictions.

For the same reasons, territorial restrictions in Licensing Agreements are subject to close scrutiny under the EC's competition rules. The recent technology transfer block exemption demonstrates the European Commission's ("Commission") continued highly regulatory approach to territorial restraints, despite the block exemption's more relaxed view of licensing restraints in general. The current debate about vertical restraints has so far had little effect on similar restraints in Licensing Arrangements.

Well established, sacred doctrines may create questionable results. The predominance of the territoriality issue in intellectual property cases, for example, creates the real risk that the fundamental role of patent rights, such as the encouragement of innovation, does not receive adequate consideration. Another case of unduly strict enforcement of Community law is trademark law where Community law continues to disregard the trademark right holder's legitimate interest in protecting its marketing strategy, and instead encourages parallel importers to interfere with distribution systems.

For several reasons, it is justified to critically examine the current intellectual property doctrines in Community law. First, the fact that certain cases continue to arise before the Court and the Commission is perhaps the strongest evidence that rules and tests that automatically prohibit certain territorial restrictions without consideration of economic circumstances have failed to produce sustainable results. It makes little economic sense, for example, to prohibit restraints on parallel trade in the European Community when Member State regulations are the source of significantly different market conditions. At the same time, the European Community has not been able to harmonize Member

2. Treaty Establishing the European Community, Feb. 7, 1992, art. 36, [1992] 1 C.M.L.R. 573, 606 [hereinafter EC Treaty], *incorporating changes made by* Treaty on European Union, Feb. 7, 1992, O.J. C 224/1 (1992), [1992] 1 C.M.L.R. 719, 31 I.L.M. 247 [hereinafter TEU]. The TEU, *supra*, amended the Treaty Establishing the European Economic Community, Mar. 25, 1957, 298 U.N.T.S. 11, 1973 Gr. Brit. T.S. No.1 (Cmd. 5179-II) [hereinafter EEC Treaty], *as amended by* Single European Act, O.J. L 169/1 (1987), [1987] 2 C.M.L.R. 741 [hereinafter SEA], *in* TREATIES ESTABLISHING THE EUROPEAN COMMUNITIES (EC Off'l Pub. Off. 1987).

State laws that are the principal cause of market distortions. For similar reasons, right holders will continue to make rational decisions concerning their local distribution systems that reflect different marketing conditions and seek protection against interferences by third parties. The cases also reflect increasing inconsistencies between EC actions as legislator and policy-maker in the area of intellectual property rights on the one hand, and its application of free trade rules in intellectual property cases on the other hand. Third, the cases provide a good opportunity to explore the relationship between free movement of goods rules and competition rules applicable to license restraints, in particular territorial restrictions.

This Article will use recently decided intellectual property cases and other recent developments in EC competition law to critically discuss the European Community's traditional and strict pro-free trade approach in intellectual property cases. It will focus in particular on issues relating to the territorial nature of intellectual property rights. Part I of this Article examines the Court's free trade approach in free movement cases involving patent rights. Part II explores patent rights in the context of technology Licensing Agreements, in particular in light of recent antitrust developments concerning vertical restraints. Part III discusses trademark issues. It first considers free movement rules and concludes with a brief discussion of trademark Licensing Agreements and antitrust law.

I. PATENT RIGHTS AND FREE MOVEMENT RULES

In the past, patent cases have tested the limits of the Court's exhaustion doctrine. The 1996 *Merck & Co. v. Primecrown Ltd.* case highlighted the inconsistencies in the Court's case law involving parallel imports of patented products.³ The case offers

3. *Merck & Co. v. Primecrown Ltd.*, Joined Cases C-267/95 & 268/95, [1997] 1 C.M.L.R. 83 [hereinafter *Primecrown*]. *Primecrown* was pending while this Article was written and presented. In its December 5, 1996 judgment, the Court refused to follow the Advocate General, who, in a skillful Opinion had suggested overruling *Merck & Co. v. Stephar BV*, Case 187/80, [1981] E.C.R. 2063, [1981] 3 C.M.L.R. 463 [hereinafter *Merck/Stephar*]. The Court provided virtually no reasons for its conclusions, and nothing in the judgment requires reconsidering the conclusions reached in this Article. The analysis of the Article remained unchanged, with the exception of minor textual adjustments.

an opportunity to critically examine the Court's traditional position towards cases of parallel trade in patented products.

A. Free Movement Rules – Merck/Stephar and Primecrown

In *Primecrown* the Court was asked to reconsider the 1981 case of *Merck & Co. V. Stephar BV* ("*Merck/Stephar*").⁴ It is, therefore, useful to begin with a summary of *Merck/Stephar* and the reasons for the almost unanimous criticism of the judgment.

1. The *Merck/Stephar* Judgment

Merck/Stephar was the Court's most extreme application of free movement of goods rules to patent rights. It is a judgment that demonstrates the weakness of the Court's "subject matter" concept. *Merck/Stephar* extends the doctrine of Community-wide exhaustion to products that had first been marketed in a Member State where patent protection was not available. The Court held that the right holder could not use patent rights in other Member States to block intra-Community trade.⁵ The Court held that the "subject matter" of patent rights guaranteed the exclusive right to put a patented product on the market for the first time. In the Court's view, the right holder had to take the marketing decision in light of all circumstances, including the existence of patent protection in certain Member States. Once marketing has occurred, the right holder had to accept the consequences of the free movement of goods rules which were of overriding importance for both the legal and the economic circumstances.⁶

Many commentators have criticized *Merck/Stephar* and pointed out that *Merck/Stephar* could not be reconciled with principles of patent law that the Court itself pronounced in other cases.⁷ In *Pharmon BV v. Hoechst AG* ("*Pharmon/Hoechst*"),

4. See *Merck/Stephar*, [1981] E.C.R. at 2063, [1981] 3 C.M.L.R. at 463.

5. Merck could, therefore, no longer rely on its Dutch patent rights to prevent parallel imports into the Netherlands from Italy where it had first marketed unpatented pharmaceutical products.

6. *Id.* at 2067, ¶¶ 9-11, [1981] 3 C.M.L.R. at 468.

7. See, e.g., Guiliano Marengo & Karen Banks, *Intellectual Property and the Community Rules on Free Movement: Discrimination Unearthed*, 15 EUR. L. REV. 224, 247 (1990); WARWICK ROTHNIE, PARALLEL IMPORTS 351-52 (1993); Paul Demaret, *Industrial Property, Compulsory Licenses and the Free Movement of Goods Under Community Law*, 18 I.I.C. 161 (1987); Norbert Koch, *Article 30 and the Exercise of Industrial Property Rights to Block Imports*, in 1986 FORDHAM CORP. L. INST. 605, 619-20 (Barry Hawk ed., 1987).

in particular, the Court indirectly accepted that patent law grants exclusive rights to market a patented product to provide the inventor an opportunity to obtain a monopoly reward.⁸ Without exclusive production and marketing rights, commentators argued that the reward function of patent law does not exist. Consent to the first marketing of a product was irrelevant if it was not accompanied by exclusive rights.⁹

Another criticism of *Merck/Stephar* addressed the Court's one-sided, abstract market integration concept that focused exclusively on the right holder's consent and ignored economic and patent policy considerations. *Merck/Stephar's* contribution to the Community's market integration goal remained doubtful and it actually may have encouraged greater market separation.¹⁰

2. *Primecrown*

Primecrown is an important case. It not only directly challenged *Merck/Stephar*, but also what made the case so interesting was that a remark by Advocate General Fennelly squarely put before the Court the important issues of the interface of intellectual property and Community law.¹¹ What made the case in the end so disappointing is that the Court refused to consider in any detail the highly relevant arguments made during the proceedings.

a. The Facts

The facts in *Primecrown* were similar to *Merck/Stephar*. Portugal and Spain denied patent protection for pharmaceutical and chemical products for several years after the two countries

8. *Pharmon BV v. Hoechst AG*, Case 19/84, [1985] E.C.R. 2281, ¶¶ 28-30, [1985] 3 C.M.L.R. 775 [hereinafter *Pharmon/Hoechst*].

9. The Court, however, rejected this argument and instead followed a peculiar line of argument of Advocate General Mancini who had suggested that patents give only an opportunity of obtaining a monopoly reward, but did not guarantee a specific return on investment. This condition was justified, regardless of the circumstances under which the marketing had occurred.

10. see ROTHNIE, *supra* note 7, at 352.

11. The outcome of *Primecrown* is significant also in economic terms. In 1995, several Member States unsuccessfully attempted to persuade the Commission to extend the exception from the free movement of goods rules for unpatented pharmaceutical products from Spain and Portugal. Their argument was that free movement of goods rules would result in a flood of cheap imports in their markets.

joined the European Community. Both countries, meanwhile, provided for patent protection and complied with obligations under the act which admitted Spain and Portugal to the European Community.¹² Patent protection is not retroactively available, however, for products that were marketed before pharmaceutical products became patentable and, therefore, fail to meet the novelty requirement. Until patent protection becomes fully effective, pharmaceutical products that are patented in other Member States will therefore be marketed in Spain and Portugal without patent protection.¹³

b. The Advocate General's Opinion

A significant contribution in the *Primecrown* proceedings was Advocate General Fennelly's opinion ("Opinion").¹⁴ He suggested that *Merck/Stephar* be overruled because it could not be reconciled with general principles of patent law. The Opinion relied on two principal arguments. One related to patent policy and the economic effects of *Merck/Stephar*, and the other referred to conceptual problems raised by *Merck/Stephar*.

Advocate General Fennelly first pointed out that *Merck/Stephar* in effect encouraged market partitioning by right holders who might refuse to sell a product in markets where patent protection was not available. Applying the *Merck/Stephar* rule to products marketed in Spain or Portugal would lead to commercially irrational decisions. By withdrawing from Member State markets, pharmaceutical companies would avoid sales that might still be profitable. It would, moreover, undermine the right holder's ability to recover research expenditures and, therefore, reduce incentives for further research if low price levels were ex-

12. Act Concerning the Conditions of Accession of the Kingdom of Spain and the Portuguese Republic and the Adjustments to the Treaties, O.J. L 3021, at 32, 86, arts. 47, 209 (1985) [hereinafter Act of Accession].

13. A transitional period during which imports into other Member States of non-patented pharmaceutical products could be blocked has already expired or is about to expire. Articles 47 and 209 of the Act of Accession provide that the transitional period ended with respect to each country by the end of the third year after the country has made chemical and pharmaceutical products patentable. The most persuasive interpretation of these provisions is that the transitional period ended in Portugal on December 31, 1994 (three years after Portugal's accession to the European Patent Convention) and on October 6, 1995 in Spain (three years after those products became patentable in Spain). The Court confirmed these results for both countries. See *Primecrown*, [1997] 1 C.M.L.R. 172, ¶ 25.

14. *Id.*

ported to other Member States.¹⁵

Secondly, Advocate General Fennelly criticized the logic of the Court's reasoning in *Merck/Stephar* and the Court's statement that a right holder had to take the marketing decision in light of all circumstances, including the existence of patent protection in Member States, and accept the consequences of the free movement of goods rules. In the Advocate General's view, consent to marketing can be relevant only where an exclusive patent right accompanies it. Any other solution would deny the right holder's ability to exercise its patent rights to receive a monopoly reward. It would, moreover, impose one Member State's non-patent policy on the right holder throughout the Community.¹⁶

The Advocate General found support for the proposition to overrule *Merck/Stephar* in subsequent case law, in particular *Pharmon/Hoechst*.¹⁷ He also relied on *Warner Brothers Inc. v. Christiansen*, the 1988 copyright case where the Court held that sales of videocassettes in one Member State did not exhaust rental rights in another Member State.¹⁸ Finally, the Opinion included

15. Opinion of Advocate General Fennelly, *Primecrown*, [1997] 1 C.M.L.R. at 130, ¶ 112.

16. *Id.* at 129-30, ¶ 111.

17. *Pharmon/Hoechst* held that marketing of a patented pharmaceutical in a Member State under a compulsory license did not trigger Community-wide exhaustion. *Pharmon/Hoechst*, [1985] E.C.R. at 2281, [1985] 3 C.M.L.R. at 775. The Court reasoned that the compulsory license prevented the right holder from exercising the patentee's prerogative to freely consent to the marketing of a patented product. According to the Court in *Pharmon/Hoechst*, patent law gave "the inventor an exclusive right of first placing the product on the market in order to allow him to obtain the reward for his creative effort." *Id.* at 2298, ¶ 26, C.M.L.R. at 798. This, the Advocate General in *Primecrown* pointed out, required that patentability and the right holder's free consent to marketing coincide in the Member State of export before exhaustion applies. Clearly, neither *Merck/Stephar* nor *Primecrown* met this requirement.

18. *Warner Brothers Inc. v. Christiansen*, Case 158/86, [1988] E.C.R. 2605, [1990] 3 C.M.L.R. 684. In the Advocate General's view, this decision indicated that non-protection in the Member State of first marketing could not be exported into other Member States, although this part of the Opinion is not entirely persuasive. Opinion of Advocate General Fennelly, *Primecrown*, [1997] 1 C.M.L.R. at 137-39, ¶¶ 133-34. It is not at all clear that *Warner Brothers* marked a fundamental departure from previous case law with regard to the relationship between Member State law and Community law, contrary to the Advocate General's Opinion and a view occasionally expressed by other commentators. *Id.*; see, e.g., ROTHNIE, *supra* note 7, at 368-71 (stating that *Warner Brothers* exposed the magician's hand). *Warner Brothers* is a case about two different types of exclusive rights, the distribution right and the rental right. They are separate parts of the bundle of exclusive rights included in the exclusive copyright. In *Warner Brothers*, the distribution right in the video cassettes was exhausted after the first sale in the

an attack on the 1981 *Musik-Vertrieb Membran/GEMA* decision, a copyright case where the Court held that marketing of records in one Member State under a voluntary license that was granted against the background of a possible statutory license triggered exhaustion and prevented the right holder from blocking imports of the record into another Member State.¹⁹

c. The *Primecrown* Judgment

In its December 1996 judgment in *Primecrown*, the Court refused to overrule *Merck/Stephar*.²⁰ With a few conclusory statements, the Court held that there was no reason to deviate from previous case law. The Court insisted that the first marketing in the European Community triggers exhaustion and the right holder had to consider in advance the consequences of marketing products in a Member State where patent protection was not available.²¹ An exception existed only if the producer were under a legal obligation to market the products in a Member

United Kingdom as much as anywhere else in the European Community. *Warner Brothers* is, therefore, not a case about restrictions on parallel imports. Imports into Denmark were permitted, and only certain forms of exploitation were subject to the right holder's control. Rental rights, on the other hand, are not affected by the sale of a copyrighted object. They would not have been affected in the United Kingdom if they had already existed at that time and they were not affected in any other Member State. Neither did sales in Denmark affect the Danish rental rights. *Warner Brothers* is more like *Coditel*: a performance right is not exhausted by the public showing of a copyrighted product such as a movie. Along the same lines, a sale of a copyrighted object does not exhaust rental rights. From this perspective, *Warner Brothers* arguably has little precedential value for the issues raised in *Primecrown*. The more difficult question arising from *Warner Brothers* is whether obtaining a rental license in one Member State permits the licensee to rent the copyrighted products throughout all other Member States. The better view is that it does not, despite subsequent harmonizing legislation in the form of the Rental Rights Directive that required all Member states to provide for a rental right. See Council Directive No. 92/100/EEC, O.J. L 346/61 (1992). In other words, the grant of a rental license is limited to the territory of the Member State where the right was granted and does not extend to other Member States.

19. *Musik-Vertrieb Membran GmbH and K-tel Int'l v. GEMA* (Gesellschaft für musikalische Aufführungs- und mechanische Vervielfältigungsrechte), Joined Cases 55/80 & 57/80, [1981] E.C.R. 147, 2 C.M.L.R. 44 [hereinafter *Musik-Vertrieb*]. Advocate General Fennelly admitted factual differences between *Musik-Vertrieb* and *Primecrown*. In *Musik-Vertrieb*, the marketing of the records in the United Kingdom was authorized by a voluntary license between the right holder and record producer. Advocate General Fennelly, however, correctly dismissed those differences as formalistic. The availability of a statutory license limited the right holder's freedom to grant or refuse a license and, moreover, indirectly determined the maximum royalty rate.

20. See *Primecrown*, [1997] 1 C.M.L.R. 83.

21. *Merck/Stephar*, [1981] E.C.R. at 2081, ¶ 7, [1981] 3 C.M.L.R. at 481.

State where patent protection was not available.²²

Primecrown is a disappointing judgment because the Court stubbornly refused to consider the economic aspects of market integration in its deliberations. Instead, the Court almost mechanically repeated traditional doctrines²³ and did not attempt to develop more persuasive reasons in support of its ruling.

B. Free Movement Rules – Considerations Beyond *Primecrown*

The most important issues raised in *Primecrown* are related in particular to the economic effects of parallel trade, the Court's concept of market integration, and the significance of government intervention for the free movement of goods rules. These issues are not necessarily new and have been discussed in the legal and economic literature.²⁴ They were rarely addressed, however, with such directness in Court proceedings as they were in *Primecrown*.

The following section considers whether greater recognition of economic effects and the state of market integration within the European Community may justify changes in free movement of goods rules.

1. Market Integration

Concerns about the territorial nature and market partitioning effects of intellectual property rights are the crucial aspect in the Court's intellectual property rights case law. The scope of intellectual property rights may be limited in order to allow greater market integration.²⁵ This approach assumes that limit-

22. *Id.* at 2080, ¶ 5, [1981] 3 C.M.L.R. at 480.

23. The Court, for example, stated that market distortions caused by different price legislation in Member States must be remedied by measures taken by Community authorities. While this is in principle a correct statement, it does not help the right holder in the present situation. The Court simply ignores that Community institutions have not been able or willing to adopt such measures since the Court in the 1974 *Centrafarm/Sterling Drug* case made this statement for the first time. See *Centrafarm BV*, [1974] E.C.R. at 1164-65, ¶¶ 22-25, [1974] 2 C.M.L.R. at 505.

24. See, e.g., ROTHNIE, *supra* note 7; PAUL DEMARET, PATENTS, TERRITORIAL RESTRICTIONS, AND EEC LAW: A LEGAL AND ECONOMIC ANALYSIS (1978).

25. The Court has reasoned that accepting the patentee's right to block imports of products that have been put on the market with the right holder's consent in another Member State would enable the patentee to partition off national markets and, thus, restrict intra-Community trade. See *Centrafarm BV*, [1974] E.C.R. at 1163, ¶ 12, [1974] 2 C.M.L.R. at 504; See also *Parke, Davis & Co. v. Probel, Reese, Beintema-Interpharm* and

ing the scope of intellectual property rights, in particular a right holder's ability to block parallel imports, will contribute to a greater degree of market integration.²⁶

In some cases, however, the Court relied on an entirely abstract idea of an integrated market. The right holder's consent to the first marketing in the European Community was automatically sufficient to trigger exhaustion, regardless of existing differences between the market conditions in Member States. The Court refused to recognize that regulatory intervention on the Member State level prevented greater integration, not the right holder's strategic use of its intellectual property rights. Limiting intellectual property rights in these cases will not contribute to market integration.

Cases like *Primecrown* question the Court's market integration concept. Advocate General Fennelly made this point when he stated, "[t]he diverging policies of Member States regarding the patentability of pharmaceutical products was the real cause of the non-uniformity in the common market."²⁷ Forcing the right holder to accept parallel imports in these circumstances "effectively imposes on patentees the discipline of the Common Market where it does not in fact exist."²⁸

This assessment is very much in line with a 1991 Commission-sponsored study on parallel trade in pharmaceutical products in the Community. The Report reached the conclusion that:

Any measures aimed at stimulating parallel trade in pharmaceutical products while leaving widely diverse and regulated national price regimes intact will not create a single market in the Community. A market economy requires market pricing, and market pricing creates the conditions under which the prices converge to the point where parallel trade ceases to be profitable.²⁹

Centrafarm, Case C 24/67, [1968] E.C.R. 55, [1968] C.M.L.R. 47; Deutsche Grammophon Gesellschaft GmbH v. Metro-SB-Grossmärkte GmbH & Co. KG, Case 78/70, [1971] E.C.R. 487, [1971] 1 C.M.L.R. 631 (discussing rights related to copyright).

26. Parallel imports will lead to greater uniformity by limiting the right holder's market power in local markets and gradually eliminate the possibility of price discrimination.

27. Opinion of Advocate General Fennelly, *Primecrown*, [1997] 1 C.M.L.R. at 97-98, ¶ 25-28.

28. *Id.* at 129-30, ¶ 111.

29. REMIT CONSULTANTS, IMPEDIMENTS TO PARALLEL TRADE IN PHARMACEUTICALS

These statements suggest that Community law rules concerning intellectual property rights cannot be a substitute for a market integration policy. In particular, Advocate General Fennelly's Opinion suggested instead that the rights of patentees and other holders of exclusive intellectual property rights be analyzed in light of the legal and economic circumstances in Member States. Such considerations have rarely played a role in cases involving intellectual property.³⁰ The Advocate General's suggestion to consider the real status of market integration before deciding whether parallel imports are desirable, in terms of both integration policy and economic effects, is a significant challenge to the prevailing attitude towards parallel imports.

2. Economic Effects of Parallel Imports

It is remarkable that in a case before the Court a member of the Court expressly referred to economic consequences of Community free movement rules. Advocate General Fennelly referred in particular to possible welfare losses. He argued that inadequate free movement rules might reduce production output if the right holders withdraw their products from low price markets, and also reduce research and development output by limiting the reward that right holders are able to obtain within the common market.³¹

The arguments raise interesting questions about the economic effects of parallel imports, especially in connection with intellectual property rights. Economic literature suggests that the economic effects of parallel trade and greater market integration largely depend on the differences of demand elasticities in local markets. Exact predictions appear difficult. The prevailing differences between the price levels in Member State pharmaceutical markets, however, and the various forms of govern-

WITHIN THE EUROPEAN COMMUNITY 84 (1991). For a similar conclusion, see Concepción Fernández Vicién, *Why Parallel Imports of Pharmaceutical Products Should Be Forbidden*, 17 EUR. COMPETITION L. REV. 219, 224 (1996) (stating that submitting distribution and sales of pharmaceutical products to effective competition on EC market basis is undesirable so long as different levels of protection of research and development and different mechanisms of public intervention exist).

30. For notable exceptions, see, e.g., S.A. Compagnie Générale pour la Diffusion de la Télévision, *Coditel v. S.A. Ciné Vog Films*, Case 62/79, [1980] E.C.R. 881, [1981] 2 C.M.L.R. 362 [hereinafter *Coditel I*]; *Pharmon/Hoechst*, [1985] E.C.R. at 2281, [1985] 3 C.M.L.R. at 775; *Warner Brothers*, [1988] E.C.R. at 2605, [1990] 3 C.M.L.R. at 684.

31. *Primecrown*, [1997] at 1 C.M.L.R. at 128, ¶ 108 (Fennelly, A.G.).

ment intervention may support the Advocate General's assumptions about the economic effects of a pro-parallel trade policy.

The argument in favor of unrestricted intra-Community trade in grey market goods is based on the conventional market integration model that assumes that, with the move towards a more integrated market, firms will lose market power and their price/cost margins will decline.³² Consumers will benefit from increased competition and reduced prices. Overall welfare will increase.³³ Parallel imports, therefore, obviously play an important role in the market integration process. It should lead to an erosion of discriminatory prices and eliminate inefficiencies resulting from price discrimination. The EC Treaty incorporates this economic model of market integration.³⁴

Rules in favor of parallel imports, however, are not always justified. Unrestricted trade in grey market goods may lead to lower outputs, compared to the case of separated markets and restrictions on parallel imports.³⁵ If disparities of demand elasticities increase significantly, suppliers may choose relatively high uniform prices at which low demand countries may go unserved

32. See, e.g., J. Haaland & I. Wooton, *Market Integration, Competition, and Welfare*, in *TRADE FLOWS AND TRADE POLICY AFTER 1992* 112, 125-26 (L. Alan Winters ed., 1993) [hereinafter Winters] (referring also to concept of "reciprocal dumping" where market shares and prices charges in export markets are relatively lower than in domestic markets). *Id.*

33. See, e.g., Smith & Venables, *Completing the Internal Market in the European Community*, 32 *EUR. ECON. REV.* 1501-25 (1988); Winters, *supra* note 32, at 3, 8-19; Haaland & Wooton, *supra* note 32, at 125-26; see also COMMISSION, *RESEARCH ON THE COST OF NON-EUROPE: BASIC FINDINGS* (1988) (discussing other factors such as scale economies and reduction in trade barriers that resulted from different regulatory regimes in Member States).

34. EC Treaty, art. 2, [1992] 1 C.M.L.R. at 573. Article 2 defines economic growth, raised standards of living, and economic cohesion as principal Community goals. The creation of a common market, Article 2, and an internal market, Article 3, are only tools to achieve these goals. See, e.g., W. Bishop, *Price Discrimination Under Article 86: Political Economy in the European Court*, 44 *MOD. L. REV.* 282, 289 (1981); see also T. Frazer, *Competition Policy After 1992: The Next Step*, 53 *MOD. L. REV.* 609, 616-17 (1990) (arguing that if increased efficiency, economic expansion, and raised standards of living are considered as overriding goals of EC Treaty, market integration and removal of geographical barriers should not be single focus of competition policy).

35. See, e.g., Malueg & Schwartz, *Parallel Imports, Demand Dispersion, and International Price Discrimination*, Economic Analysis Group Discussion Paper, at 6-12 (1993); Bishop, *supra* note 34, at 287-88; see also Klepper, *Pharmaceuticals: Who's Afraid of 1992?*, in *TRADE FLOWS AND TRADE POLICY AFTER 1992* 143, 168 (L. Alan Winters ed., 1993) (stating that decline in welfare appears more likely when price control schemes become less effective and prices move towards more uniform prices and that losses in consumer surpluses will most likely outweigh increased producer surpluses).

or underserved. With fewer low elasticity countries served, output is reduced and producers will reoptimize the price and raise prices further.³⁶

Economic arguments against unrestricted parallel trade are even more persuasive in connection with intellectual property rights. Concerns about possible negative static welfare effects of price discrimination become less significant because the right holder's increased profits may provide an incentive for further innovation.³⁷ Allowing for price discrimination in order to increase the innovator's reward may, moreover, be more efficient than increasing the innovator's reward by extending the duration of intellectual property right protection.³⁸

Advocate General Fennelly was correctly satisfied that parallel imports are in principle capable of producing negative output effects if market conditions are sufficiently different. He rejected suggestions that restrictions on parallel imports be allowed only where evidence suggested, on a case by case basis, that government intervention was likely to have adverse effects on research and development and production output levels.³⁹ It

36. Malueg & Schwartz, *supra* note 35, at 3, 19 (arguing that these considerations apply in particular on regional or international level, where differences in income and demand elasticity between markets are more significant than within one country, including the European Community); *see also* Bishop, *supra* note 34, at 294 (positing that permitting price discrimination probably is best rule for European Community, considering informational deficit to exactly assess output and distributive consequences of price discrimination); Klepper, *supra* note 35, at 168-69 (arguing that European Community policy to achieve uniform pricing in pharmaceutical markets may lead to welfare losses compared to scenario with price discrimination). Klepper's result is based on the assumption that marginal cost pricing is not achievable because market conditions are not uniform.

37. *See, e.g.*, Bishop, *supra* note 34, at 290; Hausman & MacKie-Mason, *Price Discrimination and Patent Policy*, 19 RAND J. ECON. 153, 263 (1988).

38. Hausman & MacKie-Mason, *supra* note 37, at 263. Price discrimination may open up new markets for innovation because it helps to recover the high costs of discovering new uses and adopting innovations for new uses. New uses will frequently require additional research and development efforts to modify properties or to combine given properties with other goods. In these cases, price discrimination can help to increase output because a uniform price would not provide enough incentive to sink necessary research and development costs. Encouraging entry into new markets will advance market integration with greater certainty than an artificially imposed uniform price requirement. *See, e.g.*, Ergas, *Economic Aspects of Competition Policy Applied to Information Based Services*, in COMPETITION LAW AND INFORMATION BASED SERVICES 133, 138 (1993). *But see* J.S. Chard & C.J. Mellor, *Intellectual Property Rights and Parallel Imports*, 12 WORLD ECON. 69, 78 (1988) (assuming that parallel trade has insignificant output effects).

39. Opinion of Advocate General Fennelly, *Primecrown*, [1997] 1 C.M.L.R. at 130 ¶ 112.

is arguable that in his view it was sufficient that economic models predicted negative effects on output and on welfare.

3. Government Intervention and Price Regulation

Because of the narrow facts before him, in *Primecrown*, Advocate General Fennelly considered primarily whether the absence of patent protection in the Member State of export created sufficiently different conditions in local markets to justify restrictions on parallel trade. A broader application of this rationale suggests, however, that the right holder's freedom to set prices should also be a precondition for the application of free movement of goods rules. In other words, if Member States of export intervene in the market and do not allow a free formation of prices to determine how much compensation the patent right holder receives, negative effects of parallel imports on output and research and development are also likely.⁴⁰ If Member State intervention in the form of non-patentability of products should limit the effects of the exhaustion doctrine,⁴¹ the effects of price regulation in Member States of export and their effects on the free movement of goods rules should also be relevant.⁴²

The Court's position on the issue of price regulation is well established. In *Centrafarm BV v. Sterling Drug Inc.* ("*Centrafarm/Sterling*"), price regulation in a Member State of export "cannot justify the maintenance or introduction by another Member State of measures which are incompatible with the rules governing the free movement of goods, in particular in the field of

40. *See id.* In terms of Articles 30 and 36 of the EC Treaty, if certain forms of government intervention exist in the Member State of export, first marketing of products in that Member State should not trigger exhaustion, regardless of the right holder's actual compensation.

41. *Pharmon/Hoechst* holds, for example, that restrictions on the right holder in form of compulsory licenses in the Member State of export justify restrictions on parallel imports. *Pharmon/Hoechst*, [1985] E.C.R. at 2281, [1985] 3 C.M.L.R. at 775. Advocate General Fennelly in *Primecrown* suggested that the lack of patent protection in the exporting Member State be treated along the same lines. Opinion of Advocate General Fennelly, *Primecrown*, [1997] 1 C.M.L.R. at 130-31, ¶ 113. Advocate General Fennelly also argued that first marketing does not trigger exhaustion if the possibility of a statutory license eliminates the right holder's freedom to decide whether to grant a license and to determine the terms of the license. *Id.* at 131, 114.

In all these cases, regulatory intervention in the Member State of export makes the exhaustion doctrine inapplicable.

42. *See also* Santiago Martinez Lage, *State Price Control and EC Competition Law*, in 1995 FORDHAM CORP. L. INST. 161 (Barry Hawk ed., 1996).

industrial and commercial property."⁴³

Interestingly, neither the Advocate General, the intervening Member States, nor the Commission suggested that the Court should reconsider its position. This may be not surprising in the case of Member States. They are apparently primarily concerned about the freedom to maintain their current price control regimes without interference by Community law.⁴⁴ It is surprising, though, that Advocate General Fennelly uncritically adopted the same view and merely repeated the Court's price control statement in *Centrafarm/Sterling Drug*. His position on price control is not consistent with his arguments about the lack of patent protection in Spain and Portugal. Non-protection and government price controls in the Member States of first marketing may have similar economic effects.

It is difficult to see the difference between a system of indirect price control through denial of patent protection⁴⁵ and other forms of direct price control. Advocate General Fennelly criticized that *Merck/Stephar* may lead to the withdrawal of the products in the Member States with no patent protection and reduce overall output in the common market.⁴⁶ The same effects are likely if Member States suppress the prices that right holders can charge for their patented products. The losses from parallel imports into high price countries in both cases might encourage the right holder to withdraw the product from markets in low price countries.

Second, as Advocate General Fennelly suggested, free movement of goods rules may not result in the export of one Member State's restrictive legal regime into other Member States. This

43. *Centrafarm BV*, [1974] E.C.R. at 1147, [1974] 2 C.M.L.R. at 481; see also *Primecrown*, [1997] 1 C.M.L.R. at 175-76, ¶ 47. This statement is a conclusion and not an explanation for the rule. Moreover, it suffers from a certain circularity. The Court stated that Member State measures that restrict parallel imports cannot be maintained if they are incompatible with the rules concerning the free movement of goods. It was, of course, exactly the question before the Court under which conditions restrictions on imports rules infringe EC law.

44. *Id.* In their submissions in *Primecrown*, the Member States and Commission apparently emphasized that national price regulations were permissible as part of Member State health and social security policies. See Opinion of Advocate General Fennelly, *Primecrown*, [1997] 1 C.M.L.R. at 150, ¶ 163.

45. If a Member State altogether denies patent protection to eliminate the inventor's potential market power and to encourage copyists to market competing products, it uses this system to limit the price that the inventor can charge.

46. *Id.*

would infringe the interests of the right holders and impose on them a Community-wide regime where such a common market does not exist. Query whether a logical distinction exists between exports of a non-patent policy and exports of price controls.

In light of the *Primecrown* facts and the Advocate General's analysis, it is arguable that a link exists between free movement of goods and the existence of a market-based patent law system that enables a right holder to charge for the protected product what the market allows.⁴⁷ If such a system is absent in the Member State of export, the principle of Community-wide exhaustion may result in negative economic effects and should not be applied uncritically. For example, one could argue that marketing in a Member State where the government directly fixes prices does not trigger exhaustion.⁴⁸ At least one Advocate General considered that this might be the appropriate rule.⁴⁹

4. Forcing Member States to Act

Judgments that restrict the freedom of parallel imports might benefit market integration in the long run, in particular with regard to pharmaceutical markets. Currently, virtually all Member States appear to favor parallel imports. This is not surprising in the case of high price, importing countries. It appears somehow counterintuitive in the case of low price, exporting Member States. Their pro-parallel trade attitude may perhaps be best explained by the fact that certain industry sectors benefit from export opportunities.⁵⁰

In the current situation, a Member States' best strategy is to

47. See Demaret, *supra* note 7, at 175.

48. This does not mean that the European Community should condemn all forms of government intervention in health care markets or pharmaceutical markets. It only means that free movement of goods rules should not be permitted to export one Member State's regulation into another Member State.

49. Bristol-Myers Squibb and Others v. Paranova, Joined Cases C-427/93, 429/93 & 436/93, [1997] 1 C.M.L.R. 1151; Eurim-Pharm v. Beiersdorf and Others, Joined Cases C-71/94, 72/94 & 73/94, [1997] 1 C.M.L.R. 1222; MPA Pharma v. Rhône-Poulenc, Case C-232/94, [1996] E.C.R. I-3671.

50. One might expect that low price Member States would favor restrictions on parallel imports into other countries. Allowing unrestricted parallel trade originating in their territories arguably has negative welfare effects for their consumers. Prices in the country of export will increase, at least in the long run, if parallel trade eliminates price differentials between markets. A liberal parallel import regime might, moreover, reduce output in the low price country.

maintain the current rules and ensure the benefits of parallel imports. The negative effects of the current situation are external and largely fall on the right holders. The right holders' return on investment is reduced when parallel trade exports artificially low prices into other Member States.⁵¹

Perhaps, then, a Court judgment that allows for greater restriction of parallel imports would encourage Member States to harmonize their national health care regimes to the point where unrestricted, parallel imports will again be permissible. Parallel imports would presumably still occur after partial harmonization because price levels, demand elasticities, and income levels are different.⁵² Only after partial harmonization that removes, for example, direct price controls, however, could parallel imports effectively fulfill their function of gradually eliminating unjustified price differences between geographic markets.

5. Industrial Policy and Patent Legislation

Recent EC moves towards stronger intellectual property protection, in particular in connection with patent protection in the pharmaceutical industry,⁵³ are apparently based on the assumption that broader intellectual property rights increase the right holder's revenues and indirectly encourage increased research and development activities. In a 1994 document, the Commission specifically referred to improved intellectual property protection as a tool to strengthen the EC pharmaceutical industry. At the same time, the Commission warned Member States against weakening the pharmaceutical industry in the interest of national health and social security policies.⁵⁴

The commitment to stronger intellectual property rights is

51. See also REMIT CONSULTANTS, *supra* note 29, at 79-81 (concerning allocation of profits from parallel imports, all parties in distribution channel benefit at expense of manufacturer.)

52. See, e.g., *Merck's AIDS Drug Marketing Policy*, WALL ST. J., Oct. 11, 1996, at 1 (reporting that price differences likely to remain, even though pharmaceutical manufacturer implemented new price policy charging same wholesale price throughout Europe for certain drugs).

53. See, e.g., Council Regulation No. 1768/92, Concerning the Creation of a Supplementary Protection Certificate for Medicinal Products, O.J. L 182/1 (1992). Similar developments occurred in the area of copyright, specifically the 1993 Copyright Term Directive and the 1996 Database Directive. See Council Directive No. 93/98/EC, O.J. L 209/13 (1993) (Copyright Term Directive); Council Directive No. 96/9/EC, O.J. L 77/20 (1996).

54. Communication from the Commission to the Council and the European Par-

based exactly on the market-based patent law model⁵⁵ and, arguably, also by the Advocate General's Opinion in *Primecrown*. This raises questions about free movement rules that encourage trade in grey market products.⁵⁶ The current approach to encourage parallel trade and at the same time increase the term and scope of intellectual property rights may not represent the most efficient balance between static welfare losses and dynamic welfare gains. Providing additional incentives to inventors by expanding the scope and duration of intellectual property rights might impose higher costs on society than allowing some form of price discrimination, without increasing the amount of revenue that right holders receive.⁵⁷ Expanding the scope and duration of rights might moreover restrict access to existing technology for competing innovators. Promoting more rapid dissemination of technology appears more desirable than supporting parallel traders, considering that trade in grey market products contributes nothing to technological development.⁵⁸

C. Conclusions on Patent Rights and Free Movement Rules

Cases like *Primecrown* demonstrate the weakness of the Court's "subject matter" test. The Court defined the subject matter of patent rights as the patentee's exclusive right to manufacture a product and put the patented product on the market within the European Community for the first time.⁵⁹ If applied with a single-minded focus on the right holder's consent to the first marketing, the "subject matter" test ignores the circumstances under which marketing in the common market occurs. Consent to marketing, however, must be considered in light of the economic conditions under which the products were put on the market. Otherwise, the mechanical application of pro-paral-

liament on the Outlines of an Industrial Policy for the Pharmaceutical Sector in the European Community, COM (93) 718 final.

55. See *supra* note 30 and accompanying text (discussing cases holding legal and economic circumstances as considerations in intellectual property disputes).

56. See also Fernández Vicién, *supra* note 29, at 51.

57. See Hausman & MacKie-Mason, *supra* note 37, at 263.

58. See Frazer, *supra* note 34, at 621 (arguing that focus on development of new technology model provides possible foundation of post-1992 EC competition policy). Frazer also noted that restrictions which affect Community markets would be accepted where they lead to an increase in innovation. *Id.*

59. Opinion of Advocate General Fennelly, *Primecrown*, [1997] 1 C.M.L.R. at 127-28, ¶ 107.

lel trade rules may have undesirable economic consequences. Parallel imports raise concerns not only if a Member State fails to provide patent protection, but also where a Member State intervenes in the market in the form of price controls.

This suggests that rather than mechanically using the "subject matter" test to find Community-wide exhaustion, the Court should perhaps use a proportionality test like in other Article 36 cases to decide whether first marketing exhausts intellectual property rights throughout the European Community. This would allow the Court to take a broader range of patent policy concerns into account, in particular where economic circumstances in Member State markets are significantly different.

II. TECHNOLOGY LICENSING AGREEMENTS

The territorial nature of intellectual property rights has an equally dominant influence on the evaluation of intellectual property Licensing Agreements. It resulted in a broad application of Article 85(1) to territorial license restraints. Two recent developments suggest, however, that traditional views concerning the application of Article 85(1) to territorial restraints may gradually change. First, the 1996 Technology Transfer Agreement Block Exemption⁶⁰ ("Technology Transfer Block Exemption") indicates that the Commission might analyze direct sales restrictions in Licensing Agreements with greater flexibility. Second, the European Community's current vertical restraints debate should also affect the analysis of license restrictions.

A. *Technology Transfer Block Exemption – Direct Sales Prohibitions*

The very detailed regulation of territorial restraints in the Technology Transfer Block Exemption provides evidence that certainly in the Commission's view, territorial restraints are the key issue in Licensing Agreements. With respect to direct sales prohibitions, however, the Technology Transfer Block Exemption expresses at the same time uncertainty about the scope of Article 85(1) of the EC Treaty, the applicability of Articles 30 and 36 of the EC Treaty, and the relationship among these pro-

60. Commission Regulation No. 240/96 on the Application of Article 85(3) of the Treaty to Certain Categories of Technology Transfer Agreements, O.J. L 31/2 (1996) [hereinafter Technology Transfer Block Exemption].

visions.⁶¹

Article 1 of the Technology Transfer Block Exemption appears to assume that territorial restrictions generally fall under Article 85(1) of the EC Treaty and need an exemption to be enforceable.⁶² At the same time, Article 2(14) of the Technology Transfer Block Exemption confirms that a patentee may rely on its patent rights to prevent direct sales of a licensee outside the licensed territory.⁶³ This creates the odd result that a right holder can rely on its patent rights against direct sales without infringing free movement of goods rules and competition rules, but can enforce the licensee's contractual obligations only so long as the prohibition from direct sales is exempted under the Technology Transfer Block Exemption. The licensor would therefore be better off by omitting any reference to direct sales from the license agreement and enforcing patent rights if direct sales occur.

This situation raises the question of how the free movement of goods rules under Articles 30 and 36 affect the application of Article 85(1) to territorial restrictions in Licensing Agreements. In Recital 11 of the Preamble to the Technology Transfer Block Exemption, the Commission apparently assumes that the two

61. See *id.* pmb., recital 11, O.J. L 31/2, at 3 (1996).

62. The Commission may analyze exclusive licenses differently. Recital 10 explains that the grant of exclusive rights may fall outside Article 85(1) under certain circumstances. *Id.* pmb., recital 10, O.J. L 31/2, at 3 (1996). Whether the Commission is really committed to a full economic analysis as required under *Maize Seed*, however, appears doubtful. See L.C. Nungesser KG and Eisele v. Commission, Case 258/78, [1982] E.C.R. 2015, [1983] 1 C.M.L.R. 278 [hereinafter *Maize Seed*]. The Commission apparently assumes, for example, that any extension of exclusivity beyond the terms permitted in Article 1 requires an individual exemption under Article 85(3) and states that such exemption might be granted, in particular, if it is necessary to protect expensive and risky investment. See Technology Transfer Block Exemption, *supra* note 60, pmb., recital 14, O.J. L 31/2, at 5 (1996). The *Maize Seed* principles appear applicable in exactly those circumstances. Where the type of investment justifies the grant of exclusive rights, Article 85(1) should be inapplicable and, therefore, make an exemption under Article 85(3) unnecessary. It remains to be seen whether, under the new Technology Transfer Block Exemption, the Commission will follow the Court in *Maize Seed* and find an infringement only after a full economic analysis to a greater extent than under the two previous block exemptions.

63. The language of the Technology Transfer Block Exemption appears to apply only to a patentee, not to an exclusive licensee who grants a territorially limited sublicense. Arguably, however, the holder of an exclusive license should have the same rights as the patentee.

sets of rules are related to a certain extent.⁶⁴ The issue will become particularly important should the Court eventually confirm that the exhaustion doctrine does not apply to direct sales.⁶⁵

One solution to this problem is to completely separate the analysis of direct sales under free movement of goods rules and competition law. In other words, that enforcement of intellectual property rights may be permissible under Articles 30 and 36 of the EC Treaty does not prejudice the antitrust analysis of territorial restraints. Whether prohibitions from direct sales infringe Article 85(1) would then depend only on an antitrust analysis of the license agreement and its anticompetitive effects. In other words, even if Articles 30 and 36 do not prohibit the enforcement of patent rights, direct sales restrictions may still be found invalid under competition rules.

Another approach would be to use an analysis similar to that used in *Ideal-Standard*. In *Ideal-Standard*, the Court held that an agreement to assign trademark rights which was compatible with Articles 30 and 36 did not automatically infringe Article 85(1). Article 85(1) applied only if additional evidence existed for an anticompetitive purpose of the agreement.⁶⁶ In the context of patent Licensing Agreements, and assuming that blocking direct sales is compatible with Articles 30 and 36, this sug-

64. Technology Transfer Block Exemption, *supra* note 60, pmbl., recital 11, O.J. L 31/2, at 4 (1996). Recital 11 provides:

The exemption of export bans on the licensor and on the licensees does not prejudice any developments in the case law of the Court of Justice in relation to such agreements, notably with respect to Articles 30 to 36 and Article 85(1). This is also the case, in particular, regarding the prohibition on the licensee from selling the licensed product in territories granted to other licensees (passive competition).

Id.

65. The Court has never directly decided whether the free movement of goods rules prohibit the enforcement of patent rights against sales by a licensee outside the licensed territory. The Court's language in free movement and intellectual property cases suggests, however, that the exhaustion doctrine does not apply to direct sales. The Court stated that exhaustion applies after products have been put on the market in the Member State of export. The Commission traditionally took the opposite view. See James Venit, *In the Wake of Windsurfing: Patent Licensing in the Common Market*, in 1986 FORDHAM CORP. L. INST. 517, 523-26 (Barry Hawk ed., 1987). The reversal of *HAG I* and the end of the common origin doctrine removed a major argument in favor of the Commission's position.

66. IHT Internationale Heiztechnik GmbH v. Ideal-Standard GmbH, Case C-9/93, [1994] E.C.R. I-2789, [1994] 3 C.M.L.R. 857.

gests that direct sales prohibitions are compatible, in principle, with Article 85(1), unless additional factors demonstrate that the agreement restricts competition.⁶⁷

The second approach is, of course, similar to the first one. In both cases, Article 85(1) should be applied only after an analysis of the facts of the case. The *Ideal-Standard* approach is nevertheless preferable in the context of EC competition law, considering the Commission's tendency to automatically find that export restrictions infringe Article 85(1) of the EC Treaty only to then exempt the restrictions for a limited time under Article 85(3) of the EC Treaty. An analysis similar to the analysis in *Ideal-Standard* would require a full analysis of all circumstances under Article 85(1) before finding that prohibitions from direct sales infringe competition law. A more or less mechanical application of Article 85(1) to direct sales prohibitions would no longer be permissible.⁶⁸

B. Territorial Restraints in Patent Licensing Agreements

The application of Article 85(1) of the EC Treaty to restraints in Licensing Agreements is an important issue not only within the context of the Technology Transfer Block Exemption. It is even more significant with respect to Licensing Agreements that do not benefit from the Technology Transfer Block Exemption. A development that might influence the analysis of license restraints in general is the current debate about the application of Article 85(1) to vertical restraints in general.

67. A violation of Article 85(1) may exist, for example, if export prohibitions are used to divide markets between two licensees with considerable market power that are at least potential competitors. A third approach would grant immunity from Article 85(1) for territorial restrictions if the enforcement of intellectual property rights are compatible with Articles 30 and 36. A combined analysis of *Coditel I* and *Coditel II* rules out that approach. The two cases demonstrate that restrictions that are compatible with free movement rules may nevertheless infringe Article 85(1).

68. An approach similar to that used in *Ideal-Standard* would confirm that an analysis like that used in *Maize Seed* applies to direct sales prohibitions. See *Maize Seed*, [1982] E.C.R. at 2015, [1983] 1 C.M.L.R. at 278. The Court in *Maize Seed* was ambiguous on this issue. *Id.* at 2068-2074, ¶¶ 52, 55, 77 [1983] 1 C.M.L.R. at 352-356. The logic of *Maize Seed* strongly suggests, however, that limited territorial protection in the form of export restrictions may fall outside Article 85(1). With respect to the grant of exclusivity, the Court required consideration of economic circumstances, such as the protection of the licensee's investment and strengthening of inter-brand competition, before finding an infringement of Article 85(1). The same considerations that in the Court's view justified exclusive licenses may apply to prohibitions from direct sales.

1. Vertical Restraints and License Restraints

Even though Licensing Agreements and vertical arrangements outside the licensing context raise, in part, different anti-trust concerns, the two areas have certain issues in common. In particular, the criticism that EC competition law views a restriction on the freedom of action of the parties as a restriction of competition and puts too much emphasis on certain clauses rather than analyzing the market structure and the impact of an agreement on the market equally applies to Licensing Agreements. In both cases, the debate focuses on the question of whether a full economic analysis should be part of the Article 85(1) analysis or be reserved for the application of Article 85(3) of the EC Treaty.⁶⁹

The courts have moved towards greater recognition of economic principles and put more emphasis on market structures in evaluating vertical restraints under Article 85(1).⁷⁰ Several commentators approved this development.⁷¹ The Court of Justice, in a much earlier case, required an analysis of economic circumstances to assess restrictions in Licensing Agreements.⁷² The Commission's practice, however, has not followed the Court's approach in either area.⁷³

69. See, e.g., David Deacon, *Vertical Restraints Under EU Competition Law: New Directions*, in 1995 FORDHAM CORP. L. INST. 307, 309-10 (Barry Hawk ed., 1996) (providing general discussion of vertical restraints). The licensee's freedom to act used to be an important concern of EC competition law. The Technology Transfer Block Exemption indicates that the restriction on the freedom of action rationale may be of lesser importance in the future.

70. *Delimitis v. Henninger Bräu AG*, Case C-234/89, [1991] E.C.R. I-935, 5 C.M.L.R. 210; see also *Langnese-Iglo GmbH v. Commission*, Case T-7/93, [1995] E.C.R. II-1533 (Ct. First Instance); *Schöller Lebensmittel GmbH & Co. KG v. Commission*, Case T-9/93, [1995] E.C.R. II-1611. Collectively these cases are called the *Ice Cream* cases. The Court has not been entirely consistent in recent judgments. See *Bundeskartellamt v. Volkswagen AG*, Case C-266/93, [1995] E.C.R. I-3477, I-3517 ¶ 23, [1995] 4 C.M.L.R. 478, 505 (holding that restriction of individual freedom of distributors infringe Article 85(1)).

71. Barry Hawk, *System Failure: Vertical Restraints and EC Competition Law*, 32 COMMON MARKET L. REV. 961, 973 (1995); Deacon, *supra* note 69; Christopher Bright, *Deregulation of EC Competition Policy: Rethinking Article 85(1)*, in 1994 FORDHAM CORP. L. INST. 505 (Barry Hawk ed., 1995).

72. See *Maize Seed*, [1982] E.C.R. at 2078, [1983] 1 C.M.L.R. at 352-56; *Coditel SA v. Cine-vog Films SA* [1982] E.C.R. 3381, [1983] 1 C.M.L.R. 49 [hereinafter *Coditel II*] (finding territorial restraints); *Bayer AG and Maschinenfabrik Hennecke GmbH v. Sülthöfer*, Case C 65/86, [1988] E.C.R. 5249, [1988] 4 C.M.L.R. 182.

73. See, e.g., *Schöller Lebensmittel GmbH & Co. KG*, O.J. L 183/1 (1993); James D. Veltrop, *Tying and Exclusive Purchasing Arrangements Under EC Competition Law*, 31 COM-

Licensing restrictions and restrictions in other vertical arrangements do not always raise identical antitrust concerns. For example, horizontal elements in the licensor-licensee relationship may be more common in a licensing agreement than in distribution arrangements. Licensing restrictions may have effects not only on the product market, but also on the upstream market for the licensed and competing technologies. Such risks may be less important outside the licensing context. The risk and uncertainty faced by both sides, on the other hand, may be more significant in a Licensing Agreement. This factor and the ease of misappropriation may justify otherwise anticompetitive restrictions.

The differences, however, do not justify considering licensing restraints as particularly suspect when compared to restraints in other vertical agreements. Intellectual property rights do not automatically create market power and are not inherently anticompetitive.⁷⁴ Intellectual property rights, therefore, should not be subject *per se* to an antitrust analysis that is fundamentally different from the analysis of other vertical arrangements. Intellectual property-specific concerns can be taken into account in evaluating the specific market circumstances.⁷⁵

2. Market Structure

As in the case of vertical arrangements in general, restrictions on the freedom to act are not automatically a restriction of

MON MARKET L. REV. 549 (1994)(criticizing Commission's reluctance to follow the principles pronounced by the Court in *Delimitis*).

74. See, e.g., U.S. Dep't of Justice & Federal Trade Comm'n, 1995 Intellectual Property Antitrust Guidelines, ¶ 2.1 (Apr. 1995) [hereinafter 1995 Intellectual Property Guidelines]. Attempts to develop intellectual property right-specific antitrust rules failed to provide workable standards.

75. Certain justifications for territorial restraints in vertical agreements outside the licensing context may be less persuasive if applied to Licensing Agreements. An important argument in favor of territorial restraints in distribution arrangements is the close relationship between distributor and manufacturer where both influence the manufacturer's production and marketing decisions. In this case, where the distributor's feedback is critical, interference with the cooperative relationship between distributor and manufacturer through unauthorized imports appears undesirable. See e.g., Deacon, *supra* note 69, at 319. A similar argument applies to license arrangements only where the licensee's marketing efforts are a dominant element in a licensing arrangement. It is less persuasive if the licensee's independent research and development efforts to further develop the licensed technology are the principal aspect of a license arrangement because cooperation between the licensee and the licensor appears less important.

competition.⁷⁶ If the licensor and licensee are in a vertical relationship at the time they enter into a license agreement, restrictions in Licensing Agreements do not restrict competition so long as the restrictions affect only the parties' freedom to act. In this case, effects on third parties are the major concern, including the license agreement's effects on the dissemination of competing technology and the development of new technology.

Restrictions that affect the position of third parties may occur in the markets for technology and intellectual property rights as well as the markets for products. Exclusivity provisions in favor of the licensee may, for example, restrict competition if the licensee's competitors are denied access to important inputs such as the licensed technology.⁷⁷ The licensor's competitors might be denied market access with regard to their technology if exclusivity clauses prevent a significant number of potential licensees from using competing technology.⁷⁸

Licensing Agreements, at least between parties in a vertical relationship, and other vertical arrangements, therefore, have in common that anticompetitive effects largely depend on the market structure and the position of the parties concerned. If the licensee and licensor have no market power in either market,

76. See generally Deacon, *supra* note 69; Hawk, *supra* note 71. In one respect, restrictions on the parties' freedom to act may be of greater relevance in Licensing Agreements. Restrictions in Licensing Agreements may affect the licensee's independent Research and development efforts, at least where the licensee controls the necessary resources for such activities. One example of restrictions that affect the upstream market for technologies are exclusive grant back provisions that give an incumbent control over significant areas of newly developed technology. Non-competition provisions that make it impossible for licensees to switch to competing technology might be another case where the licensor controls significant parts of the market so that there are fewer outlets for competing technology. These concerns about effects on upstream markets provide yet another argument to treat territorial restraints more leniently and focus only on the effects on third parties. Territorial restrictions are unlikely to reduce the incentive to innovate.

77. Intellectual property rights always have exclusionary effects. The licensee's competitors may never have access to the relevant technology because of the patentee's exclusive rights. The main concern is, therefore, that the licensee increases market power by acquiring control over competing technologies, and, thus, prevents competition between technologies.

78. Foreclosure of market access for competing technology might be more relevant than similar foreclosure effects in non-intellectual property related vertical arrangements. At least in some markets, the number of potential competent licensees will be small. See, e.g., F.J. CONTRACTOR, INTERNATIONAL TECHNOLOGY LICENSING: COMPENSATION, COSTS AND NEGOTIATION 112 (1981); R. Caves et al., *The Imperfect Market for Technology Licenses*, 45 OXF. BULL. ECON. & STAT. 249, 250 (1983).

restrictions in Licensing Agreements are unlikely to raise anticompetitive concerns. Attempts to restrict access to technology or to raise prices in the product market would fail as long as markets are not concentrated and competing technologies or products are available. Competition from other technologies or products reduces the risk that restrictions on intra-brand competition will have negative effects.⁷⁹ This applies to territorial restraints as well as non-territorial restraints.

Interestingly, the Technology Transfer Block Exemption does incorporate a reference to market structure as a factor to assess the lawfulness of territorial restrictions. Article 7 empowers the Commission to withdraw the block exemption where a license agreement is incompatible with Article 85(3) of the EC Treaty. Article 7(1), in particular, refers to a licensee's market share as a relevant factor and indicates that insufficient competition might exist if the licensee's market share exceeds forty percent of the relevant market.⁸⁰

Article 7(1) of the Technology Transfer Block Exemption indicates that the Commission is prepared to apply a broader analysis of market circumstances to determine possible anticompetitive effects of Licensing Agreements. The same reference to market structure should apply to determine that anticompetitive effects are unlikely in circumstances where the parties clearly do not possess market power. This would allow the conclusion that territorial restrictions between parties without significant market shares create no danger of restricting competition.

79. See, e.g., OECD, *COMPETITION POLICY AND VERTICAL RESTRAINTS: FRANCHISING AGREEMENTS* (1994) [hereinafter *FRANCHISING AGREEMENTS*]; Deacon, *supra* note 69, at 316; see also Schöller, [1995] E.C.R. II-1611 (stating that assessment of competitive effects of exclusive purchase obligation requires analysis of market conditions). Although the *Ice Cream* cases dealt only with exclusive purchase obligations, the Court of First Instance's reasoning appears to apply in general to vertical restrictions. See Deacon, *supra* note 69, at 313.

80. This is the light version of the much criticized provision in the Commission's original proposal which would have made the Technology Transfer Block Exemption automatically inapplicable if the licensee held a market share above 40%. Preliminary Draft Commission Regulation (EC) of 30 Sept. 1994 on the Application of Article 85(3) of the Treaty to Certain Categories of Technology Transfer Agreements, art. 1(8)(6) (1994) O.J. C 178/3, at 8-9, as corrected by O.J. C 187/16 (1994). Earlier drafts circulated to Member States were even more restrictive and provided for the block exemption's inapplicability at even lower market shares. See Valentine Korah, *The Preliminary Draft of a New EC Group Exemption for Technology Licensing*, 16 *EUROPEAN INTELL. PROP. REV.* 263, 265 (1994) (criticizing the proposed market share cap).

The situation changes, however, when the relationship ceases to be purely vertical and horizontal elements exist in the relationship, or in other words, if the licensor and licensee are at least potential competitors at the time they enter into the license agreement. This is the case, for example, when the licensor is active in both the upstream and the downstream markets and grants a license for the manufacture of competing products.⁸¹ Horizontal effects may also exist with respect to possible coordination among either the licensor or the licensee and their respective competitors.⁸² Restrictions in Licensing Agreements with horizontal elements might still be beneficial, but additional scrutiny is required to ensure that license restrictions, in particular territorial restrictions, are not used as facilitating devices in either the upstream or the downstream markets.⁸³ The Technology Transfer Block Exemption clearly demonstrates the importance of distinguishing purely vertical agreements from agreements with horizontal elements and of subjecting horizontal restrictions to a more careful analysis.⁸⁴

3. Territorial Restraints

If the notion of restriction of economic freedom is replaced by greater emphasis on market structure and an agreement's effects on the market, the analysis of territorial license restraints should follow the same principles.⁸⁵ Territorial exclusivity in Li-

81. Interestingly, the 1995 Intellectual Property Guidelines assume that license arrangements typically will be vertical. 1995 Intellectual Property Guidelines, *supra* note 74, ¶ 3.3. This contrasts with the analysis of license arrangements under Article 85(1), where the Commission traditionally assumed that license arrangements include horizontal elements. See, e.g., Venit, *supra* note 65, at 522, n.17.

82. The grant of exclusive territories by competing licensors to their licensees, for example, may result in higher prices than would prevail in circumstances without territorial restraints.

83. See, e.g., Baumol & Ordover, *Antitrust: Source of Dynamic and Static Inefficiencies*, in ANTITRUST: INNOVATION AND COMPETITIVENESS (Jorde & Teece eds., 1992); 1995 Intellectual Property Guidelines, *supra* note 74, at ¶ 3.3.

84. See Technology Transfer Block Exemption, *supra* note 60, art. 5(1), O.J. L 31/2 at 10 (1996) (stating that block exemption not applicable to certain agreements between competitors); *id.* art. 7(4), O.J. L 31/2 at 11 (1996) (positing that best efforts clause in license agreement between competitor may result in withdrawal of block exemption).

85. See also 1995 Intellectual Property Guidelines, *supra* note 74, at ¶ 4.1.2 (stating that exclusive territories and exclusive dealing restrictions in Licensing Agreements raise concerns similar to restriction outside licensing context, although ease of misappropriating intellectual property might justify otherwise anticompetitive restriction).

censing Agreements may have negative effects on competition, for example, by facilitating collusion. Licensors might use restrictions imposed on their respective licensees, for example, to coordinate prices or competing manufacturers may use territorial restrictions to divide markets.

Commentators have argued that territorial protection may be anticompetitive, even in a purely vertical agreement. Reduced intra-brand competition may allow licensees, for example, to pass on a reduction in license fees only in part to consumers. This may discourage a licensor from lowering license fees charged to licensees. Similar effects are possible if competing licensors are able to observe their competitor's attempts to increase output through lower license fees and react correspondingly through increased output. In those circumstances, territorial restraints may induce licensors to be less price aggressive.⁸⁶

The likelihood of such anticompetitive effects obviously depends again on the existence of horizontal elements in the relationship between the parties and the structure of the markets concerned. For example, strategic behavior in connection with vertical restraints that restrict competition among licensors is plausible only where the number of licensors is limited. Control over prices by either a licensee or a licensor is possible only where the downstream markets are not competitive and market entry is difficult. Entry might be possible by the use of competing technology or by marketing competing products that use unrelated technology. This suggests that concerns over territorial restrictions in vertical arrangements are justified only where markets on both levels are concentrated and barriers to entry are significant.⁸⁷

4. Article 85(1) Analysis

The above discussion and, in particular, the emphasis on the importance of market structure suggests a two step analysis of territorial restraints in Licensing Agreements. The first step is to question whether the markets are non-concentrated and the relationship between the parties is vertical. Territorial restric-

86. See e.g., OECD, *supra* note 79, at 55-56; Cindy Alexander & David Reiffen, *Vertical Contracts as Strategic Commitments: How Are They Enforced?*, 4 J. ECON. & MGMT. STRATEGY 623 (1995) (discussing vertical restraints in general).

87. See, e.g., OECD, *supra* note 79, at 58.

tions in a vertical license relationship and in non-concentrated markets are unlikely to restrict competition and, therefore, do not fall under Article 85(1) of the EC Treaty. The second step, if the market structure or the relationship between the parties raises concerns, is to examine possible intellectual property-specific arguments to justify restraints. A license agreement might be procompetitive, for example, because it combines complementary technologies of the parties. Protection of a licensee against intra-brand competition might be necessary to induce investment.⁸⁸

This two-step analysis will also facilitate the application of the *L.C. Nungesser KG and Eisele V. Commission* ("Maize Seed") factors. The first step in many cases will already lead to the conclusion that a license agreement is unlikely to appreciably affect the position of third parties. In these cases, consideration of more complex *Maize Seed* justifications becomes unnecessary.

III. TRADEMARKS

In trademark and free movement cases, the "essential function" test has played a crucial role. Major changes in trademark and freemovement case law involved a re-evaluation of the Court's definition of the "essential function" of trademark rights.⁸⁹ The "essential function" concept, however, can be an instrument to avoid a full analysis of intellectual property policy. A narrow view of the function of trademarks allows decisions in favor of free intra-Community trade in a greater number of cases.⁹⁰

Developments in trademark law and policy suggest that

88. Greater recognition of market structure elements in the Article 85(1) analysis also questions the strict distinction between restrictions providing for absolute territorial protection and limited territorial protection through export prohibitions. If economic considerations, such as the need to develop new technology or introduce new technology in a new market, justify the imposition of export bans so that those restrictions in certain cases may altogether fall outside Article 85(1) or are at least exemptible, considerations of the same kind arguably may justify stronger protection against parallel imports in the appropriate circumstances.

89. Compare *Van Zuylen Frères v. Hag AG*, [1974] E.C.R. at 731, [1974] 2 C.M.L.R. 127 [hereinafter *HAG I*], with *HAG II*, [1990] E.C.R. I at 3711, [1990] 3 C.M.L.R. at 5710.

90. In the Court's view, the right to prevent parallel imports would enable the trademark holder to partition off markets where "no such restriction was necessary to guarantee the essence of the right flowing from the trademark." *Centrafarm BV*, [1974] E.C.R. at 1162-63, ¶ 11, [1974] 2 C.M.L.R. at 503-04. The decisive question is, there-

trademark and free movement cases should include a broader analysis than currently found in the Court's case law. The same argument applies to the antitrust analysis of trademark Licensing Agreements. These issues have been raised in recent trademark cases, including *Ideal-Standard* and the repackaging cases.

A. Recent Trademark Case Law

1. The *Ideal-Standard* Case

In *Ideal-Standard*,⁹¹ the Court held that after a voluntary division of the trademark rights, Articles 30 and 36 of the EC Treaty did not prohibit the holder of a trademark right from blocking imports from another Member State of products with the same trademark which an independent right holder in the Member State of export owned.⁹² *Ideal-Standard* became the final step towards the elimination of the "common origin" doctrine in trademark cases.⁹³ *Ideal-Standard* largely relied on the reasoning in *HAG II*,⁹⁴ and like in *HAG II*, the Court emphasized the function

fore, how one defines the "essence of the right flowing from the trademark" which in subsequent judgments became the "essential function."

91. *Ideal-Standard*, [1994] E.C.R. at I-2789, [1994] 3 C.M.L.R. at 857; see, e.g., Guy Tritton, *Articles 30 to 36 and Intellectual Property: Is the Jurisprudence of the ECJ Now of an Ideal-Standard?*, 16 EUR. INTEL. PROP. REV. 422 (1994); Ian Forrester & Anne Nielsen, *Repackaging and the Grey Market in the EC: Does Ideal-Standard Provide New Hope for Trademark Owners?*, Paper delivered at the Third Annual Fordham Conference on International Intellectual Property Law and Policy (1995) (approving developments in *Ideal-Standard*). But see William Alexander, *Case Comment on Ideal-Standard*, 32 COMMON MARKET L. REV. 327 (1995) (criticizing Court for being overprotective of intellectual property rights).

92. The division of the "Ideal-Standard" mark occurred when the French and the German subsidiaries of the American Standard group initially held the rights in the "Ideal-Standard" mark in their territories and later the French subsidiary, Ideal-Standard SA, in the course of insolvency proceedings, transferred a division of its business with the "Ideal-Standard" trademark to SGF, an unrelated company in France, which later assigned the rights to CICH. CICH's German subsidiary, Internationale Heiztechnik, began to sell CICH's products with the Ideal-Standard trademark in Germany. Ideal-Standard GmbH, the German subsidiary of the American Standards Group and holder of the German Ideal-Standard trademark, sued IHT for trademark infringement.

93. *HAG I*, [1974] E.C.R. at 731, [1974] 2 C.M.L.R. at 127 (establishing "common origin" doctrine after expropriation of trademark rights in one Member State). The Court reversed *HAG I* in *HAG II*, but only with respect to an involuntary division of trademark rights. See *HAG II*, [1990] E.C.R. at I-3711, [1990] 3 C.M.L.R. at 571. *Ideal-Standard* clarified that a voluntary division trademark right did not trigger exhaustion under Community free movement rules. *Ideal-Standard*, [1994] at E.C.R. I-789, [1994] 3 C.M.L.R. at 857.

94. The Court in *HAG II* found that the function of the trademark to guarantee

of trademarks as a guarantee of the source of marked products. The Court found that consumers would not be able to identify the origin of a product if two products of independent origin bearing the same trademark could be marketed in the same territory. In the Court's view, this rationale applied after government expropriation as well as a voluntary division of trademark rights.⁹⁵

Of particular interest here is the Court's important statement about the territorial nature and independence of national trademark rights.⁹⁶ The Court found, "trademark rights are first of all territorial" and concluded that, therefore, the function of the trademark also must be assessed by reference to a particular territory.⁹⁷ In the case of assignments, the Court viewed the independence and territoriality of trademark rights as justifying the right holder's interest to block imports of products marketed in another Member State.

In sharp contrast and arguably not fully consistent with the Court's emphasis on territoriality, was the Court's position with respect to Licensing Agreements. The Court reaffirmed in dictum previous case law that denied the right to restrict parallel imports of products that originated from the same source, were produced under a license agreement, or were marketed by the right holder's distributor. The decisive factor in the Court's view was the right holder's ability to control production and quality of the products. This applied even if the right holder decided to market products of different quality under the same trademark in different Member States. Negative effects on the trademark in this case were the right holder's own responsibility. Free

the identity of the origin of a product would be jeopardized if the trademark holder could not block imports of similar goods with an identical trademark that had been marketed by an independent party. *HAG II*, [1990] E.C.R. at I-3758-59, ¶¶ 14-16, [1990] 3 C.M.L.R. at 608.

95. *Ideal Standard*, [1994] E.C.R. at I-2848-51, ¶¶ 37-48, [1994] 3 C.M.L.R. at 908-10.

96. Another important aspect is the applicability of Article 85(1) to trademark assignments. The Court emphasized that trademark assignments do not per se infringe Article 85(1). *But see* Elizabeth McKnight, *Trademark Assignments and EC Law*, 18 EUR. INTELL. PROP. REV. 271, 276 (1996). McKnight submits that the enforcement of trademark rights after assignments in the course of the sale of a business is prohibited under Article 85(1). Her view is incompatible with the facts and language in *Ideal-Standard*.

97. *Ideal-Standard*, [1994] E.C.R. at I-2843-44, I-2851, ¶¶ 21-23, 48, [1994] 3 C.M.L.R. at 905, 910 (stating that function of trademark must be assessed by reference to specific territory).

movement principles had to prevail over the right holder's interests.

Even though *Ideal-Standard* strengthened the position of right holders in cases of assignments, the Court's emphasis on unitary control and the trademark's guarantee of a single source demonstrates that *Ideal-Standard* was actually decided on a narrow understanding of the function of trademark rights. The decision in favor of the right holder after a division of trademark rights was exclusively based on the trademark's guarantee of source function.

2. Repackaged Products and Parallel Imports

In *Paranova* and the other recent repackaging cases, national courts in Germany and Denmark asked the Court to clarify the right of trademark holders to oppose imports of pharmaceutical products that had been repackaged after they had been marketed by a right holder in a Member State.⁹⁸ Danish courts also raised the question of whether the 1988 Trademark Directive ("Trademark Directive") affected the Court's interpretation of Articles 30 and 36 of the EC Treaty in repackaging cases.⁹⁹

The repackaging cases were follow-up cases on *Hoffmann-La Roche*, which for the first time had considered the trademark holder's right to oppose parallel imports of repackaged products.¹⁰⁰ In *Hoffmann-La Roche*, the Court held that Article 36 allowed, in principle, the right to prevent parallel imports of re-

98. *Paranova*, [1996] E.C.R. at I-3457; *Eurim-Pharm*, [1996] E.C.R. at I-3603. The issues raised before the Court were to a large extent similar in all cases. Eurim Pharm, Paranova, and MPA Pharma are companies specializing in parallel imports of pharmaceutical products. They bought pharmaceutical products in low price countries such as Spain, Portugal, France, Greece, and the United Kingdom, repackaged them in one form or another and imported the new packages into Denmark and Germany. The repackaging included sometimes only putting blister strips into new external packaging, replacing parts of the original package such as a spray, or cutting original blister strips to create a package with a number of tablets that was marketable in the Member State of import. In almost all cases, the parallel importer also added information in the language of the Member State of import.

99. First Council Directive to Approximate the Laws of the Member States Relating to Trade Marks, No. 89/104/EEC O.J. L 40/1 (1989) [hereinafter Trademark Directive]. In the cases brought against Paranova, the Danish courts asked the Court about the relationship between the Trademark Directive's repackaging provision in Article 7 and the Court's interpretation of Article 36 of the EC Treaty.

100. *Hoffmann-La Roche & Co. AG v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse GmbH*, Case 102/77, [1978] E.C.R. 1039, [1978] 3 C.M.L.R. 217.

packaged products on which the original trademark had been reaffixed. Restrictions on parallel imports were an impermissible disguised restriction on intra-Community trade, unless four factors were met: (a) the use of the trademark right contributed to the artificial partitioning of the markets; (b) the repackaging adversely affected the original condition of the product; (c) the right holder was not notified about the repackaging; and (d) the new packaging did not include a notice about the person responsible for the repackaging.¹⁰¹ The Court viewed this result as "unavoidable" in the interests of freedom of trade, although this was more a statement than an explanation.¹⁰²

Hoffmann-La Roche created considerable uncertainty. It was unclear, for example, what evidence was necessary to establish the right holder's "artificial market partitioning." Language in *Hoffmann La Roche* indicated that the marketing system adopted by the right holder was relevant to answer this question.¹⁰³ It was also an open question as to which side had to produce evidence of adverse effects when the original condition of a product was sufficiently "adversely affected" to make import restrictions lawful.¹⁰⁴

The adoption of the first Trademark Directive¹⁰⁵ raised additional questions. Articles 7(1) and 7(2) of the Trademark Directive include a reference to the Court's repackaging case law.¹⁰⁶ Article 7(2), in particular, provides that exhaustion does not apply after the first marketing of a product in the common market if "there exist legitimate reasons for the proprietor to oppose further commercialization of the goods, especially where the condition of the goods is changed or impaired after they have been put on the market."¹⁰⁷ It was unclear whether this

101. *Id.* at 1064-66, ¶¶ 10-14, [1978] 3 C.M.L.R. at 242-43.

102. *Id.* at 1065, ¶ 11, [1978] 3 C.M.L.R. at 242.

103. The Court stated that restrictions on parallel imports were impermissible if "the use of the trade-mark right by the proprietor, having regard to the marketing system which he has adopted, will contribute to the artificial partitioning of the markets between Member States." *Id.* at 1064-65, ¶ 10, [1978] 3 C.M.L.R. at 242.

104. National courts applied different standards after *Hoffmann-La Roche*. German courts in general provided trademark holders broad protection. See, e.g., *In re Kerlone Trade Mark*, Case 3 U 217/90, [1993] 3 C.M.L.R. 190 (Apr. 25, 1991) (Ct. App. Hamburg).

105. Trademark Directive, *supra* note 99, O.J. L 40/1 (1989).

106. *Id.* art. 7(1), O.J. L 40/1, at 5 (1989). Article 7(1) incorporates the principle of Community-wide exhaustion. *Id.*

107. *Id.* art. 7(2), O.J. L 40/1, at 5 (1989). The Community Trademark Regula-

provision went beyond the *Hoffmann-La Roche* criteria. Given the Court's oft-repeated view that trademark rights are no more than a guarantee to consumers of the source of products, it is perhaps not surprising that the Court in *Paranova* granted parallel traders a broad right to import repackaged products. The trademark holder's interests are allowed to prevail only if repackaging was capable of directly or indirectly¹⁰⁸ affecting the products' original condition.¹⁰⁹

The interference with the product at a later marketing stage is, therefore, in the Court's view the decisive factor in deciding whether Community law allowed parallel trade in repackaged products. An adverse effect on the repackaged products exists only if the condition of the product inside the packaging was affected. The mere possibility that repackaging had a negative impact on the products could not justify restrictions on parallel imports of repackaged products. Indirect effects, such as the lack of adequate information on the new packaging, however, can be sufficiently strong to allow a court to find in favor of the right holder.¹¹⁰

The parallel importer has to meet certain additional requirements before parallel imports are permissible. Examples include providing information about the repackaging and notification of the right holder.¹¹¹ Perhaps most importantly, and to

tion incorporates the same provision in Article 13(2). Council Regulation No. 40/94 on the Community Trade Mark, art. 13(2), O.J. L 11/1, at 6 (1994) [hereinafter Community Trademark Regulation].

108. The original condition could be "indirectly" affected, for example, if the repackaged product omitted important user instructions or an extra article was added by the importer which did not comply with the method intended by the manufacturer.

109. *Paranova*, [1997] 1 C.M.L.R. at 1215-16, ¶¶ 58-66. In a first step, the Court had already "clarified" that the "artificial market partitioning" element in *Hoffmann-La Roche* was largely irrelevant to decide whether parallel imports of repackaged products were allowed. The Court found that artificial partitioning of markets existed as soon as the right holder attempted to restrict imports of repackaged products that had been sold in another form of packaging in the Member State of export, regardless of the reasons for the use of different packaging, including the right holder's motives or intent. *See id.* at 1214-15, ¶¶ 52-57. The only instance where the Court would allow the right holder to oppose the import of repackaged products was where the size of the original package was already marketable in the Member State of import, and adding information in the language of the Member State of import was enough to make the products marketable. *See id.* at 1214-15, ¶ 55.

110. *Id.* at 1215, ¶ 58; *MPA Pharma* [1996] E.C.R. at I-3686, ¶30.

111. *Paranova*, [1997] 1 C.M.L.R. at 1216-17, ¶¶ 67-74; *see also Hoffmann-La Roche* [1978] E.C.R. at 1165, ¶ 12, [1978] 3 C.M.L.R. at 242.

some extent inconsistent with prior parts of the judgment, the Court added in the "other requirement" category explaining that the right holder could prevent the marketing with new packaging that adversely affected the trademark's reputation.¹¹²

In *Paranova*, the Court, moreover, found that no contradiction existed between the Trademark Directive's provisions and the Court's own interpretation of Articles 30 and 36 of the EC Treaty. In other words, the Court viewed the "legitimate reasons for the proprietor to oppose further commercialization of the products" in Article 7(2) of the Trademark Directive as coinciding with those instances where the Court's free movement case law permitted a right holder to block parallel imports and did not go any further.¹¹³

3. The Rules After *Ideal-Standard* and the repackaging cases

The Court, in the repackaging cases and in *Ideal-Standard*, continued to use a narrow definition of the function of trademarks. The definition set forth in these cases recognizes only the risk of consumer confusion about the origin of products. This approach fails to adequately address other trademark policy concerns such as interference with local distribution systems and consumer confusion with regard to the quality of products.

Paranova confirmed the Court's view that differences between Member State market regulations also have no influence on the Court's analysis of trademark-related free movement of goods rules.¹¹⁴ In the Court's view, Community-wide harmonization must remedy distortions that Member State pricing rules create. Another Member State introducing measures which are incompatible with the rules on the free movement of goods could not cause the distortion.¹¹⁵ The Court in *Ideal-Standard* mentioned in dictum that quality differences between products bearing the same mark are irrelevant as long as products are

112. *Paranova*, [1997] 1 C.M.L.R. at 1216-17, ¶ 67; *Eurim-Pharm*, [1997] 1 C.M.L.R. at 1237 ¶ 58; *MPA Pharma*, [1996] E.C.R. at 3688, ¶ 39. The source guarantee function cannot explain this additional right of the trademark holder. Significantly, the Court in this section of the judgment did not refer to the "essential function" doctrine.

113. See also Opinion of the Advocate General Jacobs, *Paranova*, [1997] 1 C.M.L.R. at 1190-92, ¶¶ 90-99.

114. *Paranova*, [1997] 1 C.M.L.R. at 1212-13, ¶ 46.

115. There is a circularity in the Court's statement. See *supra* note 43 and accompanying text (discussing harmonization of Member State measures that restrict parallel imports).

manufactured under common control. According to the Court, a producer or an entire group had to bear responsibility if quality differences resulted in consumer confusion.¹¹⁶

The use of different trademarks also may not be a viable strategy to protect a local distribution system. The trademark holder's right to oppose parallel imports of repackaged and re-labelled products goes further than in the case of simple repackaging. Parallel imports were found permissible only if the right holder's subjective intent to artificially separate markets had been established.¹¹⁷ There is now great uncertainty, however, as to what evidence is necessary to establish the intent to artificially partition markets after the Court in *Paranova* rendered the "artificial partitioning" element irrelevant in the repackaging cases.¹¹⁸

B. *Reconsidering the Functions of Trademarks*

1. General Perspectives

The Court's position on trademark rights and free move-

116. *Ideal-Standard*, [1994] E.C.R. at I-2848, ¶ 38, [1994] 3 C.M.L.R. at 908. The Court had reached the same result in *Dansk Supermarkedt, A/S v. A/S Imerco, SA*, Case 58/80, [1981] E.C.R. 181, [1981] 3 C.M.L.R. 590 (holding that trademark rights cannot be enforced against parallel imports of dinnerware from another Member States even though imported products were of secondary quality).

117. *Centrafarm BV*, [1978] E.C.R. at 1841-42, ¶¶ 21-23, [1979] 1 C.M.L.R. at 343. It is not entirely clear why the Court in *Centrafarm BV* adopted more lenient criteria. The result is not consistent with a strict application of the guarantee of origin function. As long as the trademark holder owns the rights in both the old and the newly affixed trademark, changing the trademarks cannot confuse consumers about the origin of products. It is conceivable that the Court upheld the right holder's broader rights to block parallel imports in light of the economic circumstances that will usually be behind the use of different trademarks. The trademark holder will often find it desirable to market products with similar qualities under different trademarks to specifically target different groups of customers. Prices will frequently be different, depending on differences in the demand elasticity of each consumer group. This strategy will benefit consumers because it allows the producer to better match consumer needs. Allowing for an unrestricted right of parallel imports in this case would interfere with the right holder's legitimate market strategy and also act against the public interest because it reduces the choice for consumers. See, e.g., C.W.F. Baden Fuller, *Economic Issues Relating to Property Rights in Trademarks: Export Bans, Differential Pricing, Restrictions on Resale and Repackaging*, 6 EUR. L. REV. 162, 178 (1981). Whether the Court's ruling in *Centrafarm BV* is indeed based on this form of economic analysis remains somehow doubtful. If it is, one wonders why the Court categorically rejects similar considerations in the case of parallel imports of repackaged products with identical trademarks.

118. See *supra* note 109 and accompanying text (discussing Court's rationale in *Paranova*).

ment rules appears persuasive as long as the definition of the function of trademark is confined solely to the protection of consumers against confusion.¹¹⁹ Views on the role of trademarks, however, have expanded. Correspondingly, opinions about the functions of trademarks have changed.

In legal and economic literature, commentators today describe trademarks not only as an exclusive right to indicate the origin of products towards consumers, but also as property-like rights that may represent a significant economic value for the right holder. Trademark laws today, in one form or another, reflect these additional functions. Trademarks, for example, are designed to encourage and protect the right holder's investment in the goodwill of a trademark. Trademark rights protect in certain circumstances the economic value that the right holder created. In certain circumstances, the trademark holder has the right to prevent the use of a similar sign by a third party if such use reduces the trademark's goodwill, even if the sign does not cause confusion about the origin of a product.

Interestingly, the Court in the repackaging cases apparently recognized that trademark rights protect goodwill in the trademark, independent of the source guarantee. It held that the parallel importer's use of packaging materials that damaged the trademark's reputation permitted the trademark holder to oppose parallel imports of the repackaged products. It is significant, however, that the Court did not consider that the trademark holder's right would require an expansion of the Court's own "essential function" doctrine.¹²⁰

Trademarks are also viewed as guarantees of quality. Consumers associate with a trademark a consistent quality of products, not necessarily the origin of a product. In this case, trademarks are used to make the product more attractive, not to identify the manufacturer of the product.¹²¹ Commentators have emphasized that the quality guarantee function is important also from the right holder's perspective and not only from that of

119. See also Tritton, *supra* note 91, at 426 (arguing that Court in *Ideal-Standard* recognized solely consumer interest in source of products).

120. *Paranova*, [1997] 1 C.M.L.R. at 1217-18, ¶¶ 75-76. The Court has, moreover, not yet been willing to consider that establishing local goodwill might require legal protection against imports from other territories.

121. See, e.g., N. Wilkof, *Same Old Tricks or Something New? A View of Trade Mark Licensing and Quality Control*, 18 EUR. INTELL. PROP. REV. 261, 268 (1996).

consumer interest. Trademarks enable the right holder to define and maintain a specific quality of the trademarked products.¹²² The corresponding legal right enables the trademark holder to sue for trademark infringement if a licensee fails to meet the quality standards as defined in the license agreement.¹²³

2. European Community Trademark Legislation

EC law recognizes that the guarantee of origin is only one of several functions of trademarks.¹²⁴ Several provisions in the Trademark Directive and the Community Trademark Regulation cannot be explained by the guarantee of source function alone and, therefore, reflect a broader understanding of trademark rights.¹²⁵

Article 5(1)(b) of the Trademark Directive provides, for instance, for a trademark holder's right to prevent the use of signs that are similar to the trademark if a likelihood of association between the trademark and the sign exists.¹²⁶ In this case, the

122. See Lehmann & Schönfeld, *Die neue europäische Marke: Positive Handlungsrechte im Dienst der Informationsökonomie*, 96 *GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT* 481, 487 (1994).

123. Commentators have identified several functions of a trademark in addition to the guarantee of origin and the guarantee of the quality of a product. One is the so-called advertising function which allows the right holder to use marks to influence consumers' purchasing decisions. The advertising function acknowledges the goodwill that a trademark can attract independently of the goodwill of the product. See, e.g., J. McCARTHY, *TRADEMARK AND UNFAIR COMPETITION* 116, § 3.05 (4th ed. 1996); A. Sanders & S. Maniatis, *A Consumer Trade Mark: Protection Based on Origin and Quality*, 15 *EUR. INTEL. PROP. REV.* 406 (1993). Today, trademarks are also viewed as the right holder's means of communication between the right holder and the consumer. Their function is to transfer to the consumer a certain message about the quality of a product and a certain image.

124. See Trademark Directive, *supra* note 99, pmbl., recital 10, O.J. L 40/1, at 1-2 (1989) (stating that protection of trademarks in particular to guarantee function of trademark as indication of origin). Most elements of the Trademark Directive exist also in the Community Trademark Regulation. Because this Article is concerned primarily with the relationship between Community law and Member State trademark law, the discussion will refer to the relevant provisions in the Trademark Directive that Member States had to implement by December 31, 1993.

125. See, e.g., Charles Gielen, *Harmonisation of Trade Mark Law in Europe: The First Trade Mark Harmonisation Directive of the European Council*, 14 *EUR. INTEL. PROP. REV.* 262, 264 (1992) (discussing trademark policies reflected in Trademark Directive).

126. *Id.* Article 5(1)(b) of the Trademark Directive provides for the trademark holder's right to oppose the use of:

[A]ny sign where, because of its identity with, or similarity to, the trade mark and the identity or similarity of the goods or services covered by the trade

Trademark Directive requires no association about the origin of the products. No-origin confusion is sufficient to establish the trademark holder's infringement claim.¹²⁷ Along the same lines, trademarks enjoying a reputation in a Member State may be protected against signs that take unfair advantage of the trademark's reputation or might dilute the trademark's reputation. Anti-dilution protection does not require that consumers could be misled about the origin of products. Both provisions demonstrate that trademark rights also protect the economic value of a mark against interference by third parties. Trademarks are from that perspective property-like rights, not just indications of origin.

Article 8 of the Trademark Directive is a particularly interesting provision.¹²⁸ It defines the trademark holder's ability to grant trademark licenses and the holder's rights *vis-à-vis* its licensees. Article 8(2) permits the trademark holder, for example, to sue for trademark infringement if the licensee fails to meet the quality standards set forth in the license agreement. The right holder may also grant licenses for the whole or part of a Member State and bring a trademark infringement action against a licensee who affixes the licensed mark on products outside the licensed territory. Article 8(2) has important consequences for the understanding of trademark rights. Article 8(2) shows that the quality function of trademarks enjoys legal protection.¹²⁹ It also demonstrates that trademarks can be used to control to some extent distribution channels of trademarked products. It is at the same time a strong indication that the Trademark Direc-

mark and the sign, there exists a likelihood of confusion on the part of the public, which includes the likelihood of association between the sign and the trade mark.

Trademark Directive, *supra* note 99, art. 5(1)(b), O.J. L 40/1, at 4 (1989).

127. See, e.g., Gielen, *supra* note 125; but see *Wagamama Ltd. v. City Centre Restaurants PLC*, [1995] F.S.R. 713 (Ch. 1995) (holding as insufficient evidence that association language in Article 5 of the Trademark Directive actually referred to concept of no-origin association as developed under Benelux trademark law). British trademark law, therefore, recognizes trademark infringement only when similarity between sign and trademark creates confusion about origin of products.

128. Article 8(2) of the Trademark Directive provides:

The proprietor of a trade mark may invoke the rights conferred by that trade mark against a licensee who contravenes any provision in his licensing contract with regard to . . . the territory in which the trade mark may be affixed, or the quality of the goods manufactured or of the services provided by the licensee.

Trademark Directive, *supra* note 99, art. 8(2), O.J. L 40/1, at 5 (1989).

129. Lehmann & Schönfeld, *supra* note 122, at 487.

tive's trademark protection includes the protection of local goodwill in separate territories.¹³⁰

C. *Reconsidering Free Movement Rules*

The conflict-free relationship between the Court's case law and the Trademark Directive¹³¹ is, therefore, perhaps more perceived than real. One example of possible differences is similar trademarks that independent parties hold in different Member States.¹³² Along the same lines, a possible dilution of a well-known trademark by the use of a similar sign on an unrelated product would not be protected if only the source guarantee function of a trademark was considered relevant. Such usage, however, does enjoy protection under the Trademark Directive.

These differences between the Trademark Directive's concepts and the Court's position do not automatically strengthen the trademark holder's right to block parallel imports. One may argue that the Trademark Directive's expanded scope of protection improved the trademark holder's right only *vis-à-vis* similar signs independent parties used.¹³³ It does not, however, enable right holders to divide territories.¹³⁴

130. The guarantee of origin function alone could not justify a trademark infringement action as long as a licensee puts products with a licensed trademark on the market.

131. See *Paranova*, [1996] E.C.R. at I-3457; *MPA Pharma*, [1996] E.C.R. at I-3603; see also Opinion of the Advocate General Jacobs, *Paranova*, [1997] 1 C.M.L.R. at 1178. The Court, therefore, appeared overly optimistic when it stated that because both Article 36 of the Treaty and Article 7(2) of the Trademark Directive pursued the same goal of balancing the trademark right holder's interests and the E.C. Community's free movement interest, they pursue the same result. This view is correct only if both provisions balance free movement and right holders interests in the same way. There are indications, however, that the Trademark Directive puts greater emphasis on the trademark holder's interests than the Court does.

132. This issue was raised, for example, in *Deutsche Renault AG v. Audi AG*, Case C-317/91, [1993] E.C.R. I-6227. If the guarantee of origin is the only legally recognized function of trademarks, the scope of protection against imports from other Member States of products bearing confusingly similar signs is narrower. The Court might find that EC law allows imports of trademarked products into the territory of the other right holder. Under the Trademark Directive's concept, however, protection would be available as soon as the similarity between two marks raises the possibility of an association. See *supra* note 126 and accompanying text (discussing whether Trademark Directive protects trademark holder against use of similar signs that cause association with registered trademark, even if there is no confusion about source of products).

133. *Ideal-Standard*, [1994] E.C.R. at I-2851, ¶ 48, [1994] 3 C.M.L.R. at 910.

134. See Ulrich Loewenheim, *Nationale und Internationale Erschöpfung von Schutzrechten im Wandel der Zeit*, 45 *GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT IN-*

It is, nevertheless, apparent from the above discussion of the functions of trademarks that the analysis of parallel imports and trademark rights within the European Community should involve more considerations than the Court's indication of origin versus free trade discussion.¹³⁵ There is support for this position in the Trademark Directive. Article 7(2) provides that changes of the quality of products after they have been put on the market are only one of several reasons why a trademark holder may oppose parallel imports. There should, therefore, be room to consider circumstances that go beyond what the Court currently accepts as legitimate reasons to block parallel imports.¹³⁶

1. Trademarks Functions and Territorial Aspects of Trademark Rights

A significant first step in the direction of stronger protection of trademark rights is the Court's recognition in *Ideal-Standard* that national trademark rights are independent and fulfill their functions with respect to a certain territory. The Court used this concept to explain why products with identical trademarks belonging to two different and independent right holders cannot be marketed within the same territory without compromising the trademark source guarantee.¹³⁷ The Court and Community trademark legislation have, therefore, apparently accepted that territorial protection is necessary in certain cases to enable a trademark holder to use trademarks effectively.

Even though the Court in *Ideal-Standard* rejected in dictum the idea that differences in product quality between Member State markets may entitle a trademark holder to restrict parallel imports,¹³⁸ there is a strong argument that this should not be the final answer. Like the Court in *Ideal-Standard* with respect to the trademark's source guarantee function, one may argue that

TERNATIONALER TEIL 307 (1996) (presenting similar consideration concerning possible effects of Community trademark legislation on right to control parallel imports, although only with respect to third country imports). A similar argument is that the Trademark Directive affects the trademark holder's position only in relation to licensees, but does not extend its protection to third party parallel imports.

135. See, e.g., *Paranova*, [1997] 1 C.M.L.R. at 1211-12, ¶ 40.

136. Trademark Directive, *supra* note 99, art. 13(3), O.J. L 40/1, at 6 (1989).

137. *Ideal-Standard*, [1994] E.C.R. at I-2851, ¶ 48, [1994] 3 C.M.L.R. at 910.

138. *Id.* at I-2849, ¶ 38, [1994] C.M.L.R. at 908; see also Tritton, *supra* note 91, at 426-27 (criticizing Court for making statements as obiter dicta with possible wide-ranging consequences).

trademarks protect the holder's decision to market products with a specific quality in a certain territory so that imports of products with a different quality from another local market compromise the quality guarantee function of trademarks. Trademarks protect consumers not only against confusion about the origin of products, but also against confusion about the quality of products. From the consumer perspective, confusion about the quality of a product is actually far more important than confusion about the product's origin.¹³⁹ Unrestricted parallel imports may, therefore, conflict with the quality guarantee function of trademarks because a right holder can no longer decide under what quality standards the trademarked product is put in specific markets. Consumer confusion might, therefore, interfere with the trademark holder's marketing strategy, at least where the differences are significant.¹⁴⁰ A similar idea exists in Community trademark legislation which provides for the protection of local goodwill.¹⁴¹ At least one commentator has noted after *Ideal-Standard* that this issue requires further, more careful consideration.¹⁴²

A second example might be cases where the trademark's goodwill must be established, in particular, through local investment, for example, through advertising, other promotional activities, and incentives for local distributors. If the creation of goodwill depends largely on local efforts and investment, imports will undermine the willingness to invest if similar investments are not required or not possible in the country of export.¹⁴³ This argument also applies to the European Community in those cases where market conditions continue to show significant differences. The recent OECD franchising study supports the argument that restraints on intra-brand competition may be

139. See, e.g., Tritton, *supra* note 91, at 426 (finding it illogical to only consider confusion as to origin and ignore confusion as to quality).

140. See, e.g., THOMAS SCHÖNFELD, DIE GEMEINSCHAFTSMARKE ALS SELBSTÄNDIGER VERMÖGENSGEGENSTAND EINES UNTERNEHMENS 193-96 (1994) (arguing restrictions on parallel imports should be permissible, at least where quality differences are consequence of government intervention).

141. See *supra* note 127 and accompanying text (discussing association language in Article 5 of Trademark Directive relating to no-origin associations).

142. Tritton, *supra* note 91, at 428.

143. See, e.g., Robert J. Staaf, *The Law and Economics of the International Grey Market: Quality Assurance, Free-Riding and Passing Off*, 4 INTEL. PROP. J. 191, 214-17 (1989) (noting that free-riding exists when costs of promotional activities are different in different territories).

desirable in these cases.¹⁴⁴

Repackaging cases will in certain circumstances fit into this category. The Court in *Paranova* rejected the argument that different market conditions and price levels resulting from different forms of Member State intervention in their national health care markets may ever justify restrictions on parallel imports to protect trademark holder interests.¹⁴⁵ In the Court's view, market distortions could not be remedied by another type of unlawful Member State measure that restricts intra-Community trade.

The main focus in this case, however, should be the possible adverse effects of grey market products on trademarks in the territory of the Member State of import, not market distortions that result from Member State market regulation. Parallel trade exports the market regulation and artificially low prices of one Member State into other Member States.¹⁴⁶ Parallel imports may, in this situation, limit the trademark holder's ability to recoup the investments in the establishment of local goodwill in the Member State of import where prices are not subject to regulation. This might reduce the incentive for further investments in marketing efforts. In this situation, import restrictions protect legitimate trademark interests in one Member State that are

144. See, e.g., FRANCHISING AGREEMENTS, *supra* note 79, at 41-42. Concerns about local trademark rights justify greater protection where a distributor invests in the image of products to create a reputation, in particular, if consumers believe that their experience with products of one distributor applies to products from other distributors. Parallel imports may prevent distributors from appropriating the benefits of services they supply. Without restraints on intra-brand competition, the level of services would be too low. In at least one case, the Commission was reportedly willing to consider these concerns under competition rules when the trademark holder withdrew the products from the low price market to prevent parallel imports.

145. *Paranova*, [1997] 1 C.M.L.R. at 1212-13, ¶ 46; *Centrafarm BV*, [1974] E.C.R. at 1147, [1974] 2 C.M.L.R. at 480 (holding price differences resulting from governmental intervention in national health care markets do not justify restrictions on parallel imports); see also *supra* note 43 and accompanying text (criticizing Court's statements about impermissible Member State restrictions of parallel trade as circular). Along the same lines, Advocate General Jacobs dismissed the pharmaceutical companies' argument that differences in the market conditions resulting from Member State price regulation justified the use of trademark rights to restrict intra-Community trade. See Opinion of Advocate General Jacobs, *Paranova*, [1997] 1 C.M.L.R. at 1185-86, ¶¶ 76, 79. Interestingly, Advocate General Jacobs considered that a different rule might be appropriate in the case of patent rights. *Id.* at 1185, ¶ 76.

146. Price control measures in the Member State of export presumably also suppress efforts to establish local goodwill.

not already protected in the Member State of export.¹⁴⁷

2. Exceptions Under Article 36 of the EC Treaty

The above analysis suggests that well-defined trademark policy considerations may justify restrictions on intra-brand competition through parallel imports to a greater extent than under the Court's current "essential function" test. A modification of the current rules may, for example, expand current exceptions from free movement rules under Article 36 of the EC Treaty to allow greater restrictions on parallel imports in certain cases. Such exceptions could apply where the quality of products marketed in various Member States with the same trademark goods is significantly different, particularly if the differences are the result of government regulation.¹⁴⁸ It would not be impossible to address these concerns under Article 36 and determine circumstances in which the increased protection of trademarks justifies trade restrictions. In other cases, the Court has engaged in complex balancing of conflicting interests and also required national courts to apply the same balancing of interests. The same reasonableness and proportionality standards could be used when Article 36 is applied to trademark and parallel import cases.

To a certain extent, the Court in *Paranova* has already introduced such a reasonableness test by holding that a trademark holder could oppose parallel imports of repackaged products where the inappropriate presentation of the repackaged product might harm the right holder's interests. Determining at what point the packaging is sufficiently inappropriate to justify import restrictions apparently requires national courts to engage in a fact-specific inquiry and a difficult balancing of opposing interests. Requiring a national court to determine whether products of different quality are marketed in different Member States without unlawful market separation intention and that parallel imports would interfere with the local goodwill of trademark rights cannot be more difficult than the Court's "inappropriate presentation" standards.

It would facilitate the adoption of more flexible rules if the Court abandoned the mechanical "essential function" and "sub-

147. *But see id.*, at 1185-86, ¶ 79 (rejecting argument that producers' investment in establishment of local goodwill justifies their right to block parallel imports).

148. *See, e.g.*, SCHÖNFELD, *supra* note 140.

ject matter" tests and applied the general Article 36 analysis in intellectual property cases.

D. *Trademark Licensing Agreements*

Changes in trademark policy also affect the antitrust analysis of trademark Licensing Agreements. The best starting point to analyze this issue is the *Ideal-Standard* holding that restrictions resulting from agreements compatible with Community law do not automatically infringe Article 85(1). Article 85(1) applies only if additional evidence of an anticompetitive purpose exists.¹⁴⁹

This principle should generally apply to all restrictions in Licensing Agreements that Community law accepts as legitimate uses of trademark rights. Such restrictions should be found to fall under Article 85(1) of the EC Treaty only if additional evidence demonstrates the existence of an anticompetitive purpose in the license agreement. Article 8(2) of the Trademark Directive,¹⁵⁰ for example, expressly provides for the enforcement of trademark rights if a licensee violates territorial restrictions imposed in the license agreement and affixes the trademark outside the licensed territory. Article 8(2), at least, covers grants of exclusive trademark licenses.

The grant of an exclusive trademark license may, therefore, be found to infringe Article 85(1) only after an analysis of all circumstances, including the parties' intentions and evidence of a sham agreement. In principle, it is not remarkable that a finding of an infringement of Article 85(1) requires a vigorous and complete analysis of economic and other circumstances.¹⁵¹ Such an approach certainly means, however, a significant change in the Commission practice which tends to mechanically apply Article 85(1) to the grant of exclusive licenses and reserves a fuller analysis for Article 85(3).¹⁵²

149. The Court in *Ideal-Standard* held that restrictions resulting from trademark assignments do not automatically infringe Article 85(1). *Ideal-Standard*, [1994] E.C.R. at I-2793, ¶ 59, [1994] 3 C.M.L.R. at 912.

150. See also Community Trademark Regulation, *supra* note 107, art. 22(2), O.J. L 11/1, at 8 (1994).

151. See, e.g., Hawk, *supra* note 71, at 987.

152. See Commission Decision No. 78/253 EEC, O.J. L 70/69 (1978), [1978] 2 C.M.L.R. 397 (Campari); O.J. L 100/32 (1990), [1991] 4 C.M.L.R. 391 (Moosehead/Whitbread).

Similar ideas apply to territorial restrictions beyond exclusivity-like export restrictions, especially because of the recognition that trademarks fulfill their functions with respect to a certain territory and that the protection of goodwill is among the "essential" functions of trademarks.¹⁵³ These concepts should be included in the evaluation of vertical territorial restraints in trademark Licensing Agreements. If a licensor may demonstrate that certain restrictions are necessary to establish a trademark's local goodwill, Article 85(1) should not apply unless there is evidence of an anticompetitive purpose such as market allocation among licensees.

Commentators have long argued in favor of greater flexibility in the application of Article 85(1) to vertical restraints.¹⁵⁴ Recently, a Commission official has persuasively argued that the examination of vertical restraints under EC competition law should place greater emphasis on the analysis of market circumstances.¹⁵⁵ The Courts appear to have moved in that direction, although that development has not been entirely consistent.¹⁵⁶

This section demonstrates that this approach is justified for an analysis of trademark Licensing Agreements, for example, in connection with distributorship or production franchise arrangements. In particular, trademark policy considerations support a more lenient treatment of vertical territorial restraints in addition to the general market structure and efficiency considerations. These ideas again justify a two-step analysis in trademark Licensing Agreements, along the lines of the analysis suggested above for patent Licensing Agreements.¹⁵⁷ If markets are unconcentrated, restrictions in trademark Licensing Agreements should be permissible even if they impose territorial restraints on licensees and limit competition among licensees. Article 85(1), therefore, does not apply. Concentrated markets require

153. See *supra* notes 66-68 and accompanying text (discussing Court's statement in *Ideal-Standard* that trademarks can fulfill their function only with respect to certain territory).

154. See, e.g., John S. Chard, *The Economics of Exclusive Distributorship Arrangements with Special Reference to E.E.C. Competition Policy*, 25 ANTITRUST BULL. 405, 429 (1980); Hawk, *supra* note 71; Veltrop, *supra* note 73.

155. Deacon, *supra* note 69, at 816, 819-21.

156. Compare *Delimitis*, [1991] E.C.R. at I-935, [1992] 5 C.M.L.R. at 210, and *Langnese-Iglo GmbH*, [1995] E.C.R. at II-1533, with *Bundeskartellamt*, [1995] E.C.R. at I-3477.

157. See also FRANCHISING AGREEMENTS, *supra* note 79, at 57-60.

a more careful evaluation of anticompetitive risks. This evaluation must then incorporate trademark policy-specific considerations such as the need to establish local goodwill in the trademark or to protect quality expectations associated with the trademark.¹⁵⁸

158. This second step of the analysis would be similar to the Court's Article 85(1) test in *Ideal-Standard*. The Court assumed that EC antitrust law is capable of distinguishing cases where restrictions on intra-Community trade resulting from an assignment of trademark rights were justified to protect right holder interests from cases where import restrictions were part of an unlawful agreement. The Court held that an analysis of the context of an agreement, the parties' intention, and the commitments underlying the agreement was required before finding an infringement of Article 85(1).