Berkeley Journal of International Law

Volume 9
Issue 2 *Winter*

Article 4

1992

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The Evolution of a Common Market: Limits Imposed on the Protection of National Intellectual Property Rights in the European Economic Community

by
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The goal of the European Economic Community is to establish integration by eliminating restrictions on the import and export of goods. Article 36 of the Treaty of Rome, however, provides an exception to this general rule for national intellectual property. In this article, the author argues that the Court of Justice of the European Communities construes Article 36 narrowly in order to achieve a balance between free trade and the national interest of member states to preserve the value invested in the manufacturing of intellectual property. The author examines the Court of Justice's use of the proportionality principle, the exhaustion principle, and competition law. He then compares the laws on intellectual property in the United States with those of the European Community. He asserts that the Community has a protectionist response to trade outside its member states due to the fact that, unlike the United States which has a single market, the European Community is not secure in their common market. The final goal of the Community should be to create unified Community intellectual property laws, so that national laws authorized under Article 36 are no longer necessary and trade barriers obstructing the establishment of a truly common market may be abolished.

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I.
INTRODUCTION

The trend towards unification of the European Economic Community (the "Community") into an economic and political entity is one of the most impressive and important events in the modern world. It brings together historical enemies with no common language or culture into a single federalist system of more than 320 million people, in which Community laws will preempt national laws. In order to achieve unification, the Community must not only adopt certain national laws as its own, but also offer certain compromises concerning other national laws. These compromises to specific national laws can be seen in Article 36 of the Treaty of Rome (the "Treaty").[1] Indeed, Article 36 lists exceptions whereby member states may be able to limit the Community objective of freedom of movement for goods. The framers of the Treaty of Rome included exceptions to enable national laws, considered of vital importance to the member states, to survive within the Community.

1. Treaty of Rome, Mar. 25, 1957, 298 U.N.T.S. 11. TREATY ESTABLISHING THE EUROPEAN ECONOMIC COMMUNITY [EEC TREATY] (as amended 1988).

This article focuses on the Treaty's exception for the protection of "industrial and commercial property," or intellectual property.[2] The article specifically examines the treatment of this exception by the Court of Justice of the European Communities (the "Court of Justice").[3] It explores the doctrines applied by the Court of Justice, particularly the proportionality principle, the exhaustion principle, and competition law. In order to gain a better understanding of the European approach and its chances for success, this article then looks at the treatment of intellectual property in the United States. The article concludes by offering an analysis of recent community proposals that would help the Community realize its objective of a true common market, emphasizing the efforts within the Community to harmonize and unify the laws in this area.

A. The Treaty of Rome

The Treaty of Rome serves as a blueprint for European integration. To achieve integration, the Treaty creates four "economic liberties" existing among the Community's member states, free movement of goods, free movement of persons, free movement of services, and free movement of capital.[4]

Within the Treaty provisions on the free movement of goods, there is a chapter on the elimination of quantitative restrictions between member states. Articles 30-34 prohibit quantitative restrictions on imports and exports and all measures having an equivalent effect.[5] The Court of Justice has interpreted these provisions that remove quotas and outright prohibitions as covering "measures which amount to a total or partial restraint of . . . imports, exports, or goods in transit."[6] The collective effect of this chapter enables the free movement of goods, which is essential to the achievement of a common market.

Other articles of the Treaty further accommodate the free movement of goods. Article 3 states that establishing a common market in the Community requires the elimination of "quantitative restrictions on the import and export of goods, and of all other measures having equivalent effect."[7] Article 5 also demands that the "Member States shall take all appropriate measures, whether general or particular, to ensure fulfillment of the obligations arising out of this Treaty or resulting from action taken by the institutions of the

2. For the purposes of this article, these terms refer to patent, trademark, and copyright property rights. The term "intellectual property" will be used in the discussion of American law, while the term "industrial and commercial property" will be used in the discussion of Community law.

3. The Court of Justice is the supreme authority on interpretation of the Treaty. Its decisions can be overruled only by the Court itself, through a revision of the Treaty by the member states, or by the addition of a Protocol to the Treaty. EEC TREATY, *supra* note 1, pt. 6, arts. 236, 239.

4. *Id.* pt. 2, tits. I, III.

5. *Id.* pt. 2, tit. I, ch. 2, arts. 30-34.

6. Geddo v. Ente Nazionale Risi, 1973 E.C.R. 865, 879.

7. EEC TREATY, *supra* note 1, pt. 1, art. 3(a).

Community."[8] The member states must also facilitate the attainment of the Community's objectives and must abstain from measures that would jeopardize the objectives.[9]

B. The Impact of Article 36

Nevertheless, Article 36 of the Treaty permits member states to restrict the free movement of goods. Article 36 states:

> The provisions of Articles 30 to 34 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.[10]

The Treaty framers included Article 36 because they believed the Treaty must allow member states to regulate imports and exports to the extent necessary to give effect to national policies that the member states considered of primary importance.[11] Including such a provision made the Treaty more politically palatable to the governments of the member states.

The difficulty with Article 36 lies in its contradiction of the Treaty's general principle, adhering to free movement of goods. Article 36 protects rights that are essentially national in character. Recognizing that the potential misuse of Article 36 by the national governments could lead to the erosion of the purpose of the Treaty, the Court of Justice has strictly construed this Article.

C. The Reasons for Including the Protection of Industrial and Commercial Property Within Article 36

The Community believes that in order to gain wide acceptance and maintain its political support throughout the member states, Community laws must preserve certain national rights. It considers patent, copyright, and trademark rights to be of such importance as to warrant a derogation, within limits, from complete free trade of goods.[12]

The Commission of the European Communities (the "Commission") indicates that during this century, there has been a shift in economic activity to

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8. *Id.* pt. 1, art. 5.

9. *Id.*

10. *Id.* pt. 2, tit. I, art. 36.

11. Hon. Alexander John Mackenzie Stuart, *The Court of Justice of the European Communities: The Scope of its Jurisdiction and the Evolution of its Case Law under the EEC Treaty*, 3 NW. J. INT'L. L. & BUS. 415, 431 (1981).

12. The Court of Justice even expanded its concept of industrial and commercial property to provide protection for designs. *See* Keurkoop BV v. Nancy Kean Gifts BV, 1982 E.C.R. 2853. The case concerned the design of a ladies' handbag registered with the Benelux Designs Office, under the Uniform Benelux Law on Designs. The Court held that the Uniform Benelux Law on Designs fell within the scope of Article 36. *Id.* at 2872. Thus, the proprietor of a right to design under this legislation or similar legislation of a member state may prevent the importation

the production of goods, to which considerable value has been added through the application of technology, skill, and creativity.[13] If the goods can be readily appropriated by other companies, their particular features could be copied for a fraction of the cost for research and development. For example, the Commission found that the original development of a sophisticated computer chip could cost $100 million, whereas reproduction of an existing device would cost between $50,000 and $100,000.[14] Also, complex computer programs and video and sound recordings can now be copied quickly and easily through improved technology.

The piracy of certain pharmaceuticals in Europe has received a great deal of current press attention. One recent article estimated that legitimate manufacturers lose $1.9 billion a year to counterfeit drugs.[15] Chemically, the counterfeit drugs can be almost identical to the genuine product. However, at times, the counterfeits contain harmful and sometimes fatal ingredients.[16]

Article 36 provides an inherent limitation to the concept of free trade among member states. Through its protection of industrial and commercial property, it justifies certain import restrictions since trademarks, copyrights, and patents do not exist for every product and trademark in each member state. Intellectual property would be deprived of meaning if goods manufactured without consent in other countries (where there is no protection of the intellectual property) were allowed to be imported into a country where such protection exists. Most of the disputes that arise, however, concern the use of Article 36 in connection with products manufactured or marketed in other countries with the consent of the property owner.[17]

Each type of intellectual property has a unique purpose. The following sections briefly describe the underlying reasons for creating these systems of property rights.

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of products from another member state which are identical in appearance to the registered design. This restriction will only be upheld provided that the product in question does not violate the exhaustion doctrine or competition law under Article 85. *Id.* at 2875.

13. Commission of the European Communities, *Green Paper on Copyright and the Challenge of Technology - Copyright Issues Requiring Immediate Action* 2 (1988) [hereinafter *Green Paper on Copyright*]. The Green Paper assesses the following issues perceived to require attention from the Community: piracy; home copying of sound and audio-visual material; distribution and rental rights for certain classes of work, such as sound and video recordings; protection of computer programs and databases; and the limitation on the protection available to Community right holders in non-member states.

14. *Id.* at 3.

15. Tom Masland & Ruth Marshall, *A Really Nasty Business*, NEWSWEEK, Nov. 5, 1990, at 36.

16. *Id.*

17. *See, e.g.*, Merck v. Stephar and Exler, 1981 E.C.R. 2063.

1. *Purpose of the Patent System*

The protection of patent rights is designed to encourage invention and innovation.[18] An incentive system is necessary because the risks and expenses incurred by research and development are great. The monopoly granted to a patent right holder does reduce a certain amount of competition. However, as many policy makers argue, it is the promise of monopoly power, to a great extent, that "drives firms to innovate, while on the other hand the fear of losing that power promotes continued innovation."[19] Nevertheless, the benefits of promoting innovation outweigh the problems involved in slightly reducing competition.[20] Demaret explains that "by raising the revenue expectations of prospective inventors, the patent system will, it is assumed, induce investment in research and development, increase the production of inventions and encourage innovation in the economy."[21]

However, there is a delicate balance between monopoly power and the social benefits that arise from patents. The government must always be careful that its policies do not create too many monopoly rewards for the patentee, otherwise a firm could abuse its dominant position in a manner which is detrimental to consumers. This concern has guided the development of the exhaustion principle and competition law related to industrial and commercial property.

2. *Purpose of the Copyright System*

There are several reasons for promoting copyright. Similar to the policy of granting patent rights, copyright protection is viewed as encouraging creative activity for the public benefit by granting valuable rights to authors.[22] Copyright protection additionally seeks to protect the author's reputation.

In both the United States and Europe, a work must be both original and fixed in order to be protected by a copyright.[23] The originality requirement is satisfied if the work owes its origin to the author, who independently created it and did not copy from other works.[24] The second requirement is satisfied when a work is "fixed in a tangible medium of expression" and "sufficiently

18. *See* Paul Demaret, *Patents, Territorial Restrictions, and EEC Law: A Legal and Economic Analysis*, *in* IIC STUDIES IN INDUSTRIAL PROPERTY AND COPYRIGHT LAW 3-12 (1978). For a discussion of other justifications for the patent system, see generally PENROSE, THE ECONOMICS OF THE INTERNATIONAL PATENT SYSTEM (1951).

19. Peter Kaufmann, Passing Off and Misappropriation: An Economic and Legal Analysis of the Law of Unfair Competition in the United States and Continental Europe, *in* STUDIES IN INDUSTRIAL PROPERTY AND COPYRIGHT LAW 77 (1986).

20. In order to improve upon new inventions, some economists suggest that the government should additionally encourage the transfer of new technologies through patent licensing. *Id.* at 78.

21. Demaret, *supra* note 18, at 4.

22. NEIL BOORSTYN, COPYRIGHT LAW 3 (1981).

23. *See id.* at 22; *see also* G. DAVIES & H. HUGO, CHALLENGES TO COPYRIGHT AND RELATED RIGHTS IN THE EUROPEAN COMMUNITY 14-17 (1983).

24. BOORSTYN, *supra* note 22 , at 22-23.

permanent or stable to permit it to be perceived, reproduced, or otherwise communicated for a period of more than transitory duration."[25]

The typical use of copyright is in the entertainment industry. Increasingly, however, computer technology is using copyright law to protect the design of software and electronic circuitry.

3. *Purpose of the Trademark System*

Trademark laws protect the reputation of a company as well as the consumer who expects a product to be of a certain quality based on its trademark. In today's mass production society, consumers are confronted by high search costs for the products they want to buy.[26] The market is "filled with uncertainty and imperfect and unclear information."[27] The trademark serves a valuable purpose for the consumer by allowing them to distinguish among similar products. Economists believe that the theoretically monopolistic elements of a trademark are offset by the price and quality competition that arises between differentiated products and substitutes.[28] Thus, the consumers learn from their buying experiences and the producers profit from their efforts to maintain the desired quality standard.

D. *Summary*

This article has attempted to introduce Article 36 and explain the policy reasons requiring the protection of industrial and commercial property rights through patent, copyright, and trademark law. Next, it will focus on the Court of Justice's treatment of Article 36 and the limits imposed on its use.

II.
TREATMENT OF ARTICLE 36 BY THE COURT OF JUSTICE

As Article 36 provides a derogation from a key provision of the Treaty, the Court of Justice has been careful to construe the Article narrowly. In so doing, the Court has established several doctrines to restrict the applicability of Article 36.[29] This section examines both these general and specific limitations.

25. 17 U.S.C. § 101 (1988).
26. Kaufmann, *supra* note 19, at 121.
27. *Id.*
28. *Id.* at 122.
29. The burden of proof in these cases is always on the party opposing admission of the product. *See* Firma Denkavit Futtermittel GmbH v. Minister Für Ernährung Lanowerstschaft und Forsten des Landes Nordhem-Westfallen, 1979 E.C.R. 3369, 3392, 1980 3 C.M.L.R. 513, 539; *see also Criminal Proceedings Against Sandoz BV*, 1983 E.C.R. 2445, 2464, 1984 3 C.M.L.R. 43, 58. The Court in *Sandoz* explained that because Article 36 creates an exception to the fundamental rule of free movement of goods within the Community, the burden is on the national authorities to prove that the restriction contemplated satisfies the criteria of Article 36. *Id.* In order to make a determination on restricting the product, the national authorities may ask the importer to supply all information needed to assess the facts. *Id.* at 2464-65, 1984 3 C.M.L.R. at 58-59.

A. General Limitations on the Use of Article 36

It is important to realize that there are actually two provisions in Article 36: prohibitions and restrictions (1) must be justified for the reasons listed in the Article, and (2) may not "constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States."[30] Therefore, measures must be justified under both sentences in Article 36.[31]

The Court of Justice has also ruled that Article 36 is directed only at non-economic matters.[32] This ruling has several practical effects on the member states. For example, the member states cannot use objectives such as increasing employment, reducing inflation, or increasing GNP to justify derogations from the free trade of goods. Article 36 will also not apply by analogy to a wide array of customs duties.[33]

The Article must be strictly construed to apply only to prohibitions and restrictions related to the elimination of quantitative restrictions. In other words, if the Court of Justice did not limit the scope of Article 36 and instead read the provisions broadly, it would virtually render meaningless Articles 30-34 of the Treaty. The Court refuses to apply Article 36 to economic matters because it would enable the national governments to create too many justifications for restricting the free flow of goods.[34]

The Court of Justice has also limited Article 36 to apply only to restrictions on trade between member states. The Article has been held not to apply to products imported from third countries.[35] The *EMI Records v. CBS* cases exemplify these limitations. The cases concerned the Columbia trademark, which until 1917 belonged to the same company in both the United States and Europe. Through a series of transactions, CBS acquired the trademark for the United States and EMI acquired the trademark for every Community member. CBS sought to import records from the United States into the EEC with the Columbia trademark. The Court determined that the exercise of trademark rights by EMI did not infringe upon trade between member states.[36] The Court further held that a holder of a trademark in a third country could not manufacture and market his products in the Community since the trademark protected the rights of the Community trademark owner.[37]

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30. EEC TREATY, *supra* note 3, pt. 2, tit. II, art. 36.

31. The importance of also considering the second sentence is reflected in the proportionality principal. *See infra* II. B. 1.

32. *See* Commission v. Republic of Italy, 1961 E.C.R. 317, 329; Commission v. Republic of Italy, 1982 E.C.R. 2187.

33. Commission v. Republic of Italy, 1968 E.C.R. 423, 430.

34. LAURENCE GORMLEY, PROHIBITING RESTRICTIONS ON TRADE WITHIN THE EEC: THE THEORY AND APPLICATION OF ARTICLES 30-36 OF THE EEC TREATY 218 (1985).

35. *See* EMI Records v. CBS, 1976 E.C.R. 811, 1976 E.C.R. 871, 1976 E.C.R. 913 (these three cases were brought in the national courts of different countries. When questions were certified to the Court of Justice, the cases were consolidated for purposes of oral proceedings. However, the court issued a separate opinion in each case).

36. *Id.* at 844, 1976 E.C.R. at 903, 1976 E.C.R. at 946.

37. *Id.* at 846; 1976 E.C.R. at 905; 1976 E.C.R. at 947-48; 1976 2 C.M.L.R. at 266.

Had CBS held the trademark right in only one member state, EMI would have had no protection from distribution by CBS throughout the Community.[38]

B. *Specific Limitations on the Use of Article 36*

The case law on Article 36 reveals a desire by the Court of Justice to balance the competing interests of the principle of free movement of goods with the principle of protecting nationally recognized rights.[39] This balancing approach can be seen in the development of the Court's doctrine on the proportionality principle and the exhaustion of rights principle.

1. *Principle of Proportionality*

The proportionality principle mandates that a measure will not be upheld if there is a means to achieve its purpose that would be less restrictive to intra-Community trade.[40] As the Court of Justice has said, "Article 36 is an exception to the fundamental principle of the free movement of goods and must, therefore, be interpreted in such a way that its scope is not extended any further than is necessary for the protection of those interests which it is intended to secure."[41] The second sentence of Article 36 provides the proportionality principle's basis and ensures that the Article 36 exceptions will not be abused.[42]

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38. One must distinguish this case from the gray market cases discussed *infra* III. C. The gray market involves the sale of a product by the manufacturer to a third party. The third parties then legally import the product into another market, thereby competing with the product sold by the manufacturer's licensed distributors. By contrast, EMI did not sell its products to CBS. Both companies independently owned the trademark right in a certain territory. EMI could legally prevent competition by CBS because it exclusively owned the trademark within the Community.

39. GORMLEY, *supra* note 34, at 184.

40. The concept is similar to that used by the U.S. Supreme Court in several cases to protect interstate commerce. *See, e.g.*, Dean Milk Co. v. City of Madison, 340 U.S. 349 (1951). The Court struck down local regulations prohibiting milk imports because the state's objective could have been achieved by a less burdensome means. The proportionality principle incorporates a more specific rationale when used by the Court of Justice in intellectual property cases. The Court of Justice uses the principle to balance the values of protecting intellectual property and enabling the creation of a common market. The Court of Justice has determined the essential components of intellectual property that must be preserved, despite its imposition on free trade. For a discussion of available alternatives in *Dean Milk*, see Michael E. Smith, *State Discrimination Against Interstate Commerce*, 74 CAL.L.REV. 1203, 1237-38 (1986); see also Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970); A&P Tea Co., Inc. v. Cottrell, 424 U.S. 366, 376-77 (1976).

In a concurring opinion, Justice Scalia attacked the balancing approach used in these cases to determine whether the burden on commerce imposed by a state statute is excessive. He stated the approach was "ill suited to the judicial function and should be undertaken rarely if at all." CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69, 95 (1986). Professor Regan gleefully noted an absence of any reference to a balancing test in the *CTS* case. *See* Donald H. Regan, *Siamese Essays: (1) CTS Corp. v. Dynamics Corp. of America and Dormant Commerce Clause Doctrine; (2) Extraterritorial State Legislation*, 85 MICH. L. REV. 1865, 1866-68 (1987).

41. Eggers v. Freie Hansestadt Bremen, 1978 E.C.R. 1935, 1956.

42. GORMLEY, *supra* note 34, at 210.

Regarding industrial and commercial property, the proportionality principle has been developed by the Court of Justice to limit the "permissible derogations . . . to those necessary to give effect to the 'specific object' of the right relied upon."[43] Derogations justified under Article 36 are permissible only "where such derogations are justified for the purpose of safeguarding rights which constitute the specific subject matter of this property."[44] In this way, the Court of Justice has set the parameters within which these property rights can be asserted to hinder trade between member states. Following the specific object interpretation of Article 36 leads to the interpretation that would be least damaging to such trade. Through its use of the proportionality principle, the Court of Justice has indicated that it will not allow the fundamental principle of free movement of goods between member states to be compromised for any reason. The principles are usually seen in the case treatment of patents, trademarks, and copyrights.

a. Patents

The Court of Justice defines the specific subject matter of patents as the guarantee that the patentee has the exclusive right to use an invention and place it into circulation for the first time.[45] This may be done either directly or through the grant of licenses to third parties.[46] Under this definition, a patent rewards the creativity of the inventor by allowing the patent owner to exploit his patent commercially, but only to the point where the invention is placed into circulation. Once the invention is in the market, the patent owner no longer has control over its use and can no longer earn profits. This interpretation of the subject matter of the patent is uncontroverted. By contrast, the interpretation of the specific subject matter of trademark rights has sparked controversy and has required more review by the Court of Justice to identify the rights of the trademark owner in a common market.

b. Trademarks

The specific subject matter of trademarks is the guarantee that the right holder has the exclusive right to use that trademark for the purpose of placing products protected by the trademark into circulation for the first time.[47] Its purpose is to protect the owner of the trademark from competitors who wish to take advantage of the status or reputation of the trademark.[48] Trademark rights have raised the most confusion regarding owner protection, so it is

43. *Id.* at 126. The Court of Justice first used the term "specific object" of industrial and commercial property rights with regard to copyright rights in Deutsche Grammophon Gesellschaft mbH v. Metro-SB-Grossmärkte mbH & Co. KG, 1971 E.C.R. 487, 499; 1971 C.M.L.R. 631, 657.

44. Centrafarm BV and Adriaan De Peijper v. Sterling Drug Inc., 1974 E.C.R. 1147, 1162.

45. *Id.*

46. Merck v. Stephar and Exler, 1981 E.C.R. 2063, 2080.

47. Centrafarm v. Winthrop, 1974 E.C.R. 1183, 1194.

48. *Id.*; Centrafarm v. Am. Home Prods. Corp., 1978 E.C.R. 1823, 1840.

useful to examine several specific opinions of the Court of Justice. These cases can be divided into two categories: (1) cases involving two independent trademarks in different member states having similar names; and (2) cases involving the repackaging of a trademark protected product in one country and importing of the product into another country to take advantage of price differentials between member states.

An example of the first category is *Terrapin Overseas Ltd. v. Terranova Industrie C.A. Kapferer & Co.*[49] In *Terrapin*, the Court of Justice was confronted with a case where the parties independently used similar trademarks. Terranova manufactured prepared plaster for 75 years in Germany and was the registered owner of several trademarks for various building materials. Some of the trademarks included the words "Terra," "Terranova," and "Terra Fabrikate."[50] Terrapin, an English firm, manufactured and sold prefabricated houses and components under its own trademark, "Terrapin." Terrapin operated in Germany both directly and through a subsidiary German company and applied to register the trademark "Terrapin." Terranova objected to the registration of Terrapin's trademark for fear that it would raise confusion with its own trademarks.[51]

The Court found that the trademarks had been used independently and that there had never been any agreement or economic connection between the firms.[52] Had there been some agreement, it would have indicated that there were artificial divisions within the common market. However, in this situation there was a clear conflict between the principle of free movement of goods and the legitimate interests of the owner of the threatened trademark right. The Court correctly stated that the conflict must be resolved in a manner that would protect the trademark right and prevent an artificial division of the common market. Otherwise, the specific objective of the industrial and commercial property right would be undermined.[53] Therefore, the Court allowed Terranova to prevent the importation of products bearing the "Terrapin" trademark since it could cause confusion among consumers.

The second category, involving repackaging, is exemplified in the following series of cases. In *Hoffmann-La Roche & Co. AG v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH*,[54] the Court considered another specific trademark object. Hoffmann-La Roche produced the drug Valium in Switzerland, and the German subsidiary of the firm produced the drug under license in Germany. It was sold in Germany in packages under the name "Valium Roche."[55] The British subsidiary of Hoffmann-La Roche marketed the drug in the United Kingdom at a price much lower than that at

49. 1976 E.C.R. 1039.
50. *Id.* at 1040.
51. *Id.*
52. *Id.* at 1061.
53. *Id.*
54. 1978 E.C.R. 1139.
55. *Id.* at 1141.

which the drug sold in Germany. Centrafarm imported Valium, which it had purchased in the United Kingdom, into Germany. It repackaged the drug, affixed the Hoffmann-La Roche trademark and the registration number for Valium, and added its own name, address and phone number, as well as a statement that it had repackaged the drug.[56] Hoffmann-La Roche sought to prevent Centrafarm from marketing the drug in this manner.

The Court refined its definition of the specific purpose of the trademark. It found this purpose to be the guarantee of "the identity of the origin of the trade-marked product to the consumer or ultimate user, by enabling him without any possibility of confusion to distinguish that product from products which have another origin."[57] The effectiveness of this guarantee is dependent on the assurance that a third party has not interfered with the product in a manner that would affect its condition. The Court held that the right to prevent such interference was part of the specific subject matter of a trademark and thus justifiable under Article 36.[58]

However, the Court also noted that, under certain conditions, one could not use Article 36 to prevent the free movement of goods if it would constitute a disguised restriction on trade between member states violating the second sentence of Article 36. The Court announced four conditions, which must all be met by the defendant importer to prevent the manufacturer from enforcing its restriction on trade. If these conditions are met, a restriction on trade would clearly not be beneficial and could be denied for violating the second sentence of Article 36.[59] The defendant importer must (1) establish that the use of the trademark right will contribute to the artificial partitioning of the common market; (2) show that the repackaging occurred in a manner that will not affect the quality of the product; (3) give the owner of the trademark prior notice of the marketing of the repackaged product; and (4) clearly state the repackager's name on the product. These conditions are an excellent means of ensuring that consumers can trust the trademarks on repackaged products. The conditions also prevent a trademark owner from asserting his property rights for the purpose of abusing Article 36 by partitioning markets and preventing import competition.

However, the Court of Justice did not specify how to interpret the first condition. It was unclear whether an intention to use the trademark to partition the common market had to be proven, or whether it was sufficient that reliance on the trademark right would contribute to the partitioning of the common market. In other words, was the court required to take a subjective or an objective view of the partitioning of the common market? The following decisions helped to clarify this issue. In an expansion on its holding in

56. *Id.* at 1162.
57. *Id.* at 1164.
58. *Id.*
59. *Id.* at 1166.

Hoffmann-La Roche, the Court of Justice established in *Centrafarm v. American Home Products Corp.*[60] that the owner of a trademark has the right to prohibit any unauthorized affixing of his trademark to his product, even where he owns two different trademarks for the same product.[61] The holding focuses on the subjective view of the partitioning of markets.

In this case, American Home Products owned the trademarks "Seresta" and "Serenid D" to describe a particular drug. American Home Products used Seresta in the Netherlands and Serenid D in the United Kingdom. Centrafarm bought the drug as Serenid D in the United Kingdom. It removed the mark and replaced it, without consent of American Home Products, with the Seresta mark and sold it in the Netherlands.[62]

The Court held that Centrafarm might be prohibited from this practice under Article 36 and that the national court would have to determine whether the prohibition would be upheld. The Court of Justice directed the national court to determine whether the owner of the trademark right had used the different marks for the purpose of artificially partitioning the markets.[63] If this was not American Home Products' purpose, it could prohibit Centrafarm from this practice. Therefore, the Court of Justice requested the national courts to take a subjective view of the intention of the trademark owner. Both the Commission and the Advocate General, however, took the position that the subjective view should be confined to the specific facts present in this case, where one firm owned a different trademark for the same product in two or more member states.[64] Such a practice might be indicative of a desire to partition the markets.

The Court's decision in *Pfizer v. Eurim-Pharm*,[65] however, indicates that actual intention is of lesser importance. What is of paramount concern to the Court of Justice is to prevent the misleading of consumers and the deterioration of the integrity of the trademark. Thus, if conditions two, three, and four were met by a company and there was clearly no attempt to mislead the consumer nor a danger of altering the condition of the product, the Court would not examine the artificial partitioning of markets.[66]

The *Pfizer* case involved the importation of an antibiotic, Vibramycin, into Germany by Eurim-Pharm. The drug had been produced and marketed in the United Kingdom by Pfizer's British subsidiary. Eurim-Pharm repackaged the drug without opening the internal package, clearly stated that it had done so on the outside of the package, and also informed Pfizer.[67] The Court of Justice concluded that since Eurim-Pharm had satisfied conditions two,

60. 1978 E.C.R. 1823.
61. *Id.* at 1841.
62. *Id.* at 1824-25.
63. *Id.* at 1843.
64. PETER OLIVER, FREE MOVEMENT OF GOODS IN THE EEC 165 (1982).
65. 1981 E.C.R. 2913.
66. *Id.* at 2926-27.
67. *Id.* at 2924.

three, and four, it could not have misled the consumer. This case demonstrates that the facts of a case, particularly the effect on trade between member states, appear to be the most important considerations for the Court of Justice. The national courts will be permitted to determine whether the facts of a case would allow for a restriction on the free movement of goods.

The Court of Justice properly moved in a direction that would advance free trade within the Community. If an importer is able to meet conditions two, three, and four, the only reason to deny importation would be to protect the monopoly of the trademark owner. The specific purpose of the trademark is sufficiently protected by conditions two, three, and four. In other words, the consumer will have confidence in the product's origin and know that it has not been tampered with if the importer has met the repackaging conditions. Disallowing importation because the trademark owner did not intend to partition the common market is not in the best interests of the consumer because it reduces competition. Nor is it in the best interest of the common market, because it restricts trade for no apparent reason other than to increase the monopoly power of the trademark owner. Whether the manufacturer intentionally or actually contributed to the artificial partitioning of the common market is not the relevant issue for the Court. What is relevant is to determine whether the importer correctly followed conditions two, three, and four, which if followed, adequately preserve the rights of the trademark owner.

c. Copyright

The Court of Justice mentioned the specific object of copyright law in *Deutsche Grammophon Gesellschaft mbH v. Metro-SB-Grossmärkte GmbH & Co. K.G.*,[68] but did not define it in terms of copyright.[69] However, the discussion in *Musik-Vertrieb Membran GmbH and K-tel International v. GEMA*[70] indicates that the Court of Justice treats copyright like other industrial property rights for this purpose. The Court of Justice confers protection of copyright when "exploited commercially in the form of licenses capable of affecting distribution in the various member states of goods incorporating the protected literary or artistic work."[71] The Court of Justice expanded its treatment of copyright to also cover services. In *Coditel S.A. v. Ciné-Vog Films S.A*[72] the Court of Justice added another concept of freedom to provide services when dealing with copyright under Article 36. Owners of copyrights in performances can require fees for any showing of a literary or artistic work.[73] It is interesting that the Court of Justice would expand its usual strict interpretation of Article 36 to allow freedom to provide services.

68. 1971 E.C.R. 487.
69. *Id.* at 498-99.
70. 1981 E.C.R. 147.
71. *Id.* at 161.
72. 1982 E.C.R. 3381, 3401.
73. GORMLEY, *supra* note 34, at 205.

It appears to demonstrate that where the Court is truly convinced that a restriction is justified, it will uphold the exercise of national rights.[74] It has been argued that the omission from Articles 59-66, covering freedom to provide services, of any provision protecting industrial and commercial property, was likely an oversight.[75] In *Coditel*, which concerned an authorized broadcasting of a film by cable companies, it was fair to allow a restriction preserving national industrial property rights.[76] Copyright is somewhat unique in its treatment of cinematographic works, because a film can be shown infinitely. The copyright owner should not lose rights once the film is shown the first time. Preserving this right enables the owner to derive a fair profit when exploiting his work commercially.[77]

This section has attempted to show how the Court of Justice has defined the parameters of what the industrial and commercial property rights can protect. The proportionality principle ensures that the property right owner cannot abuse its national right to restrict trade between member states. It lays the foundation for limiting the application of Article 36 to specific industrial and commercial property rights.

2. *Exhaustion of Rights Principle*

The Court of Justice uses a second principle to further restrict the property owner's rights once the protected product is placed on the market. Under the exhaustion of rights principle, the exclusive right guaranteed by national legislation on industrial and commercial property ends when the product is placed in the stream of commerce within a member state by the owner of the right or with his consent. Thereafter, the owner of the right may not oppose the importation of the product into another member state nor its re-importation into the state where it was first marketed. The principle of exhaustion is based on:

> the idea that the owner of a right has, by his own acts of utilisation, taken advantage of and thereby exhausted, the exclusive right of exploitation granted to him by law, so that certain other acts of exploitation no longer come within the protection of the right. If the owner of the right has taken all the benefits constituted by his right, he no longer needs protection, further exploitation has become free and cannot be prohibited by him.[78]

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74. *Id.* at 226.

75. *Id.*

76. 1982 E.C.R. 3381, 3400.

77. Additionally, in written observations to the Court of Justice, the government of the Netherlands cited to Article 11 of the Berne Convention for the Protection of Literary and Artistic Work "that the transmission through a cable distribution network operated by a third party of a programme which is broadcast by a television broadcasting station and is subject to copyright must be regarded as a separate communication to the public within the meaning of that Convention." See *Coditel*, 1982 E.C.R. at 3395. As a separate communication to the public of a work covered by copyright, it is always subject to the authorization of the copyright owner or licensees. *See id.*

78. Deutsche Grammophon GmbH v. Firma Pop Import (Case I), Bundesgerichtsh (German Federal Supreme Court), 1982 1 C.M.L.R. 137, —.

The doctrine serves to limit the monopoly right granted for industrial and commercial property.

The Court of Justice has applied the exhaustion doctrine equally to patents and copyrights.[79] It does not distinguish between the two types of industrial property. According to this view, commercial exploitation of copyright raises the same issues as commercial exploitation of other industrial property rights.

While the same issues may be raised, the Court of Justice must be careful not to blur the differences between patents and copyrights. Indeed, there is an important distinction between them. One basis for creating the copyright system is to protect the reputation of the author. Copyright is thus more of a personal right in that the product is associated with its author, unlike a patent, where few care to know the name of the inventor. The identity of the author of a product can be just as important for sales as the product itself. Damage to products occurring during the parallel importation of a work could damage the reputation of the author. There is no guarantee that a parallel import will have the same quality as an original distribution by the author. In the following cases that focus on the exhaustion doctrine it is appropriate for the Court of Justice to treat copyrights and patents similarly. However, the Court should do so only in these specific circumstances, for it is important to distinguish between the two types of industrial property rights.

The Court of Justice first announced the exhaustion doctrine in the *Deutsche Grammophon*[80] case, applying the doctrine to copyright. Deutsche Grammophon had manufactured certain records in Germany, which it had then sold to its French subsidiary, Polydor. Metro acquired these records and Deutsche Grammophon sought an injunction to prevent Metro from selling the records in Germany under German copyright law.[81] The Court of Justice held that to grant such an injunction would isolate national markets and thus be contrary to the essential aim of the Treaty, which is to unite national markets into a single market.[82] The Court of Justice followed with its opinion in *Musik-Vertrieb Membran GmBH and K-tel International v. GEMA*.[83] The case involved a German company that placed recordings on the British market. The recordings were subsequently imported into Germany. GEMA, the German copyright protection society, brought an action

79. The Court of Justice has also applied the exhaustion doctrine to trademarks, although it is less frequently an issue in cases dealing with this type of industrial property. *See* Centrafarm v. Winthrop, 1974 E.C.R. 1183, 1194-95; Terrapin Overseas Ltd. v. Terranova Industrie C.A. Kapferer & Co., 1976 E.C.R. 1039, 1060.

80. 1971 C.M.L.R. 631.

81. *Id.* at 634-35.

82. *Id.* at 633-34.

83. 1981 E.C.R. 147.

against the importers seeking the difference in royalty fees paid in Great Britain and in Germany.[84] The Court held that because of the exhaustion principle, the party that placed the product on the market could not recover the difference in royalty fees.[85] The Court rejected the argument of the French government that copyright should be treated differently from other industrial property because it serves to protect the reputation of the author.[86] The Court explained that copyright:

> also comprises other rights, notably the right to exploit commercially the marketing of the protected work, particularly in the form of licenses granted in return for payment of royalties. It is this economic aspect of copyright which is the subject of the question submitted by the national court and, in this regard, in the application of Article 36 of the Treaty there is no reason to make a distinction between copyright and other industrial and commercial property rights.[87]

The Court finally pointed out that it is the author's choice in a common market to choose where to put his work into circulation.[88]

Expanding its concept of the exhaustion doctrine, the Court of Justice applied the exhaustion doctrine to patents in *Centrafarm BV v. Sterling Drug Inc.*[89] The Court of Justice held that once a product has been placed on the market legally by the patentee himself, or with his consent, Article 36 cannot be used as an obstacle to the free movement of this good.[90] This case arose from widely divergent prices being charged for certain pharmaceuticals in the Netherlands and Great Britain.[91] Sterling Drug owned parallel patent rights in both Great Britain and the Netherlands for the drug Negram which is used for the treatment of infections of the urinary passages. The Sterling subsidiaries in the Netherlands and Great Britain placed Negram on the market in several member states. Centrafarm subsequently imported Negram from Great Britain and sold it in the Netherlands to take advantage of the large price differential.[92]

The Court of Justice distinguished this case, in which the product was patented in several countries and placed on the market by the patentee, from the situation in which the product is imported from another member state, where it is not patentable and has been manufactured by third parties without

84. *Id.* at 150.

85. It should also be noted that Musik-Vertrieb Membran is the first case where the Court of Justice expressly ruled that Article 36 included copyright. *Id.* at 161.

86. While it is true that copyright is inherently different from other industrial property rights, the facts of this case weaken the French argument. These recordings were merely reimported into Germany. There would be no concern with the quality of the recordings and no harm to the reputation of the author.

87. *Id.* at 162.

88. *Id.* at 165.

89. 1974 E.C.R. 1147.

90. *Id.* at 1163.

91. *Id.* at 1149. British prices of pharmaceuticals were close to fifty percent higher than prices in the Netherlands. *See infra* note 157.

92. 1974 E.C.R. at 1149.

the consent of the patentee.[93] The Court accepted the exhaustion principle when the product was placed on the market by the patentee or by his consent.[94] It reasoned that if a patentee could block importations of its product, marketed by him or by his consent in another member state, the patentee would be able to partition national markets. The patentee would "thereby restrict trade between Member States, in a situation in which no such restriction was necessary to guaranty the essence of the exclusive rights flowing from parallel patents."[95] The Court rejected Sterling Drug's argument that it was protecting the public against risks arising from defective pharmaceuticals. The Court felt that such measures are properly adopted in the area of health control and must not constitute a misuse of the rules pertaining to industrial and commercial property.[96]

In a later case, the Court of Justice held that an industrial property right will be exhausted even if the products were not covered under the law of the member state where the goods were distributed by the holder of the right. In *Merck v. Stephar and Exler*,[97] Merck held a patent for a pharmaceutical product in the Netherlands, which it also put on the market in Italy. The product was not covered by a patent in Italy because pharmaceutical products could not be patented under Italian law at the time when it was first sold. Stephar acquired large quantities of the drug in Italy and resold it in the Netherlands at a lower price.[98] The Court of Justice held that the patent had been exhausted when the goods were placed on the Italian market and that a holder of a patent on a product must bear the consequences when choosing to market that product in a member state where there is no patent protection.[99] As in *Sterling Drug*, the Court clearly distinguished this case from a situation in which third parties marketed the product without the consent of the right holder.[100]

The Court of Justice has recognized several exceptions to the exhaustion doctrine. In *S.A. Compagnie Générale pour la Diffusion de la Télévision, Coditel, and Others v. S.A. Ciné Vog Films and Others*,[101] the Court limited the exhaustion doctrine to marketing through the sale of copies of the works

93. *Id.* at 1163.

94. This principle was adopted by the member states in the Community Patent Convention of 1975, Articles 32 and 81 of the Convention. *See* BRUCE I. CAWTHRA, PATENT LICENSING IN EUROPE 37 (1986).

95. 1974 E.C.R. 1147 at 1163. The Court also applied the exhaustion principal to a trademark case that arose out of the same litigation. *See* Centrafarm v. Winthrop, 1974 E.C.R. 1183 (Winthrop was a subsidiary of Sterling Drug).

96. 1974 E.C.R. at 1149.

97. 1981 E.C.R. 2063.

98. *Id.* at 2066

99. *Id.* at 2082. In connection with copyright, the Court of Justice repeated this assertion that the property right owner is free to choose where to place its work in the common market and must accept the consequences of his decision. *See Musik-Vertrieb Membran*, 1981 E.C.R. at 165.

100. *Merck*, 1981 E.C.R. at 2080-81.

101. 1980 E.C.R. 881.

in the form of physical objects; the doctrine does not apply to performance rights. Ciné Vog Films, a film distribution company, contracted with a film producer for an exclusive right for a period of seven years to show a particular film in Belgium. Later, the film's producer also assigned the right to broadcast the film in Germany to a German television station. Belgian cable television companies picked up the transmission and relayed it to their customers. Ciné Vog contended that the broadcast had jeopardized the commercial future of the film in Belgium.

The Court of Justice considered, among other issues, whether Articles 59 and 60 of the Treaty prohibited an assignment that was limited to the territory of a single member state.[102] It held that the holder of performing rights for a film in Belgium could prevent the re-transmission by cable television in Belgium of a German broadcast of the film. The producer in Belgium had legitimately calculated royalties for performances in Belgium on the actual or probable number of performances in that country.[103] Re-transmission by German television would upset the expected royalty earnings. The Court of Justice concluded that restrictions aimed at the protection of intellectual property are not prohibited, except when the restrictions are used as a means of arbitrary discrimination or as a disguised restriction on trade between member states.[104]

In another exception to full application of the exhaustion doctrine, the Court of Justice examined the exhaustion of patent rights with regard to products manufactured under a compulsory license in *Pharmon BV v. Hoeschst*.[105] The Court of Justice distinguished a compulsory license from a situation in which the holder of the patent right freely placed the product on the market, or when it was done by his consent. With a compulsory licence, there are no negotiations between the parties. The relationship which exists between the parties is different from that in a typical contractual license. When a member state grants "a third party a compulsory licence which allows him to carry out manufacturing and marketing operations which the patentee would normally have the right to prevent, the patentee cannot be deemed to have consented to the operation of that third party."[106] Otherwise

102. A series of assignments such as this would partition the common market artificially in terms of film distribution.

103. *See* 1980 E.C.R. at 902-03.

104. *Id.*

105. 1985 E.C.R. 2281. Hoechst owned patents in Germany, the Netherlands, and the United Kingdom for a manufacturing process for the drug Frusemide. Another company, DDSA Pharmaceuticals Ltd, obtained a compulsory license to exploit the invention under the patent in the United Kingdom. The license covered only the United Kingdom and included an export ban clause. The license did not originate by virtue of an agreement by the parties; it was signed only by the official of the U.K. Patent Office. *Id.* at 2283. DDSA ignored the export prohibition and later sold to Pharmon a large shipment of Frusemide pills, which Pharmon intended to market in the Netherlands. *Id.*

106. *Id.* at 2298.

the patent holder would be deprived of his rights to freely determine the conditions under which he markets his product.

In *Pharmon B.V.*, the Court allowed Hoeschst to prevent the importation and marketing of products manufactured under the compulsory license. In so doing, the court invoked the specific object of a patent right, which allows the inventor an exclusive right of first placing his product on the market, so that he may obtain a reward for his creative efforts.[107]

The exceptions to the exhaustion doctrine, concerning compulsory licenses and performance rights, indicate a willingness of the Court of Justice to use its discretion to limit the harsh effects of some of its principles. In those cases, it would have been clearly unfair to the right holder to invoke the exhaustion doctrine. Notwithstanding these deviations from the exhaustion doctrine, it is important for the common market that the Court of Justice followed this doctrine. The development of the exhaustion doctrine has closed one primary loophole that owners of national intellectual property rights could have used to have an adverse effect on the free trade of goods between member states.[108] It prevents industrial and commercial property owners from abusing their monopoly right and hurting competition.

C. Competition Law and Industrial Property

This section discusses the use of competition law to restrict the common market.

1. Relationship of Article 36 to Articles 85 and 86

Article 85(1)[109] prohibits decisions, agreements, or concerted practices between competitors that may affect trade between member states and that have as their object the restriction of competition. An exemption in Article 85(3) allows agreements with procompetitive aspects that outweigh their anticompetitive aspects.[110] Article 86 forbids abuse of a dominant position in the market.[111] The improper exploitation of an industrial property right may violate Article 86 if there is an actual or potential effect on trade.

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107. *Id.*

108. *See Green Paper on Copyright, supra* note 13, at 152.

109. EEC TREATY, *supra* note 1, pt. 3, tit, I, ch. I, art. 85. Article 85(1) prohibits those agreements which 1) fix prices; 2) limit or control production, markets, technical development, or investments; 3) share markets or sources of supply; 4) apply dissimilar conditions to equivalent transactions with other trading parties, placing them at a competitive disadvantage; and 5) make the conclusion of contracts subject to supplementary obligations, which have no connection to the subject of the contract.

110. Sara G. Zwart, *Innovate, Integrate, and Cooperate: Antitrust Changes and Challenges in the United States and the European Economic Community*, 1989 UTAH L. REV. 63, 81. Article 85(3) exempts agreements, decisions, or concerted practices which contribute to improving the production or distribution of goods or promote technical or economic progress, while being beneficial to consumers. *See* EEC TREATY, *supra* note 1, art. 85(3). *See generally* ARVED DERINGER, THE COMPETITION LAW OF THE EUROPEAN ECONOMIC COMMUNITY (1968).

111. EEC TREATY, pt. 3, tit. I, ch I, art. 86.

The Commission of the European Community frequently takes a broad view of what constitutes a restriction of competition under Article 85(1). One emphasis in the Commission's reasoning has been on the limitation of commercial freedom of the parties forming the agreement.[112] Under the restriction of freedom rationale, Article 85(1) captures a large number of agreements that would raise little competitive concern in terms of price or output effects. Since it has wide discretion in determining the applicability of Article 85(1), the Commission is able to effectively shift the antitrust analysis to Article 85(3). The Commission requires notification procedures for any agreement, decision, or practice that would fall under Article 85(3), which the Commission can use to ensure oversight power and control.[113]

Originally, the Court of Justice used Article 36 to aid its interpretations of Articles 85 and 86 with respect to competition law. Many legal theorists criticized the Court for its failure to adequately resolve conflicts between Community law and national industrial property rights through the use of Articles 85 and 86.[114] They encouraged the Court to consider other provisions in Community law. It was not until *Deutsche Grammophon*, however, that the Court of Justice began to apply Article 36 independently.[115] It is important to understand that Articles 85 and 86 have a different context from Article 36. Article 85 and 86 are intended to ensure that effective competition is preserved in the common market. Article 36, by contrast, provides an exception whereby national laws may inhibit competition and the free trade of goods among member states.

Although it is similar, this section is not included in the discussion of the proportionality principle because it involves a separate channel of analysis. In cases involving the proportionality principle, the plaintiff bases its claim on Article 36, while the defendant argues that to follow the line of reasoning of the plaintiff would be a serious derogation from the principle of the common market. By contrast, in competition law cases involving Article 36, the plaintiff will use Article 85 to ensure that competition is not prevented, while the

112. *See Hennessy/Henkell*, [Commission of the European Communities], 1980 O.J. (L 383) 11, 14-15; *National Sulphuric Acid Ass'n*, [Commission of the European Communities], 1980 O.J. (L 260) 24, 28-29.

113. Detailed information concerning the agreement, decision, or practice must be submitted on an official notification form to the Commission. The parties must seek either a negative clearance, meaning that their course of action is not prohibited under Article 85(1), or an exemption under Article 85(3). *See* EEC COMPETITION POLICY IN THE SINGLE MARKET, (an Official Publication of the European Communities), 45 (1989). Partly as a result of finding itself overburdened with Article 85(3) notifications, the Commission created the block exemption. Block exemptions exist for certain activities, which are announced in notices by the Commission. The Commission also follows a de minimis rule, whereby it will exempt agreements between smaller firms that would have little economic effect. For a discussion of the types of agreements, decisions, and practices which would qualify for an exemption or fall under the de minimis rule, see generally *id.* 23-42.

114. *See, e.g.*, HARTMUT JOHANNES, INDUSTRIAL PROPERTY AND COPYRIGHT IN EUROPEAN COMMUNITY LAW 23-28 (1976).

115. *See* OLIVER, *supra* note 64, at 156.

defendant will counter with Article 36. Like the proportionality principle, these cases concern the second sentence of Article 36, whereby enterprises allegedly use industrial property rights for abusive purposes. While the objectives of Articles 85 and 86 are quite different from those of Article 36, the Court of Justice has discussed the interaction of the Articles to prevent the erection of artificial barriers to trade between member states.

The Court of Justice addressed the interaction of Article 36 with Articles 85 and 86 in *Ets. Consten S.à.r.l. & Grundig-Verkaufs-GmbH v. Commission*.[116] Consten and Grundig had an exclusive distribution agreement allowing only Consten to import Grundig products into France, the Saar region of Germany, and Corsica. The agreement, however, prohibited Consten from re-exporting those products to other member states. The Court did not allow Consten to use Article 36 to limit the antitrust application of Article 85. Furthermore, Consten could not use its trademark right to partition off the French market, an objective that would infringe on Article 85.[117]

Even if industrial and commercial property rights recognized by a member state are not affected by Articles 85 and 86, the exercise of those rights may still fall under the prohibitions imposed by Articles 85 and 86.[118] The Court stated that the intention of the Commission in Regulation 67/67 was "not to allow industrial property rights to be exercised in an abusive manner aimed at territorial protection."[119] Article 85 would likely be infringed upon if the exercise of industrial property rights appeared to be involved in the agreement.

The Court altered this position slightly in *Parke Davis & Co. v. Probel, Reese, Beintema-Interpharm and Centrafarm*.[120] Parke Davis held patents in the Netherlands for an antibiotic. The antibiotic was marketed in Italy without the consent of Parke Davis.[121] The defendant firms imported the antibiotic from Italy and sold it on the Dutch market without the consent of Parke Davis. There was no patent protection for pharmaceuticals in Italy at that time.[122] The defendants argued that Parke Davis violated Articles 85 and 86.

The Court of Justice rejected this argument, upholding the right of Parke Davis to prohibit the import of patent infringing products from a member state where there was no patent protection. The Court found that the exercise of the patent rights could not fall under Article 85(1) in the absence of any agreement, decision, or concerted practice prohibited by the provision.

116. 1966 E.C.R. 299.

117. *Id.* at 343-45.

118. *See* Sirena v. EDA, 1971 E.C.R. 69, 81.

119. *Id.* at 82.

120. 1968 E.C.R. 55.

121. This case can be distinguished from the *Merck* case, where the plaintiff had itself placed the pharmaceutical on the market in Italy. *See Merck*, 1981 E.C.R. at 2063.

122. In 1979, Italy amended its laws to grant patent protection for pharmaceuticals. Royal Decree No. 1127, June 29, 1939, as amended by Presidential Decree No. 338, June 22, 1979 (Published in English, Industrial Property, WIPO (October 1981)).

It also could not fall under Article 86 in the absence of any abuse of a dominant position.[123] In other words, the exercise of industrial property rights do not per se infringe Articles 85 and 86 in the absence of any actions that these Articles explicitly prohibit.

The Court of Justice considered the interaction of Articles in *Sirena v. Eda*.[124] An American company, Mark Allen, sold its trademark "Prep" to the Italian company Sirena, which re-registered the mark for itself. In Germany, Mark Allen kept its trademark, but licensed it to a German manufacturer. Sirena manufactured cosmetic and medicinal cream, which it marketed in Italy under the trademark. Eda imported a similar product manufactured by the licensee in Germany and sold it in Italy under the same trademark, "Prep."[125] Thus, historically there was common ownership of the trademark, and so according to the Court of Justice, Sirena had no right to enforce its infringement claim in Italy against Eda. The Court of Justice was concerned that industrial property rights not "be excercised in an abusive manner in order to create absolute territorial protection."[126]

Finally, in *Terrapin*,[127] the Court of Justice held that imports could be restricted under Article 36, provided that there were "no agreements restricting competition and no legal or economic ties between the undertakings and that whose respective rights have arisen independently of one another."[128] The Court did not clarify whether it prohibited any agreements restricting competition, or only those that violated Article 85. Article 85 may be implicated "where the exercise of national industrial property rights appears to be the object, means, or consequence of an agreement."[129] If only those agreements that violate Article 85 would be prohibited, then de minimis agreements, agreements the procompetitive efficiencies of which outweigh their anticompetitive aspects under Article 85(3), or agreements falling within a block exemption would not bar the use of Article 36 to restrict importation. The language used by the *Terrapin* Court, however, indicates a strict interpretation prohibiting any agreement.[130]

Through these cases, the Court of Justice has been able to balance the interests of preserving adequate competition, while retaining the monopoly rights inherent in industrial and commercial property. The decisions allow the Commission to objectively examine the assertion of industrial and commercial property rights on a case-by-case basis. Article 85 will be implicated where these property rights are asserted due to an anticompetitive agreement.

123. *Parke Davis*, 1968 E.C.R. at 72.
124. 1971 E.C.R. 69.
125. *Id.* at 73, 85.
126. *Id.* at 82.
127. [1976] 2 C.M.L.R. 482.
128. *Id.* at 506.
129. GORMLEY, *supra* note 34, at 230.
130. *Id.* at 232.

These cases have also helped to release Article 36 as an independent means of analyzing cases involving industrial and commercial rights.

2. *Territorial Restraints*

Community law has developed a separate means of analyzing competition cases involving Article 36 and territorial restrictions in patent licensing and sales to distributors. The concept of a territorial restriction at first glance seems to be contrary to the goal of the free movement of goods. However, Community law allows these restrictions in patent licenses, but not in sales agreements with distributors.

The practice of patent licensing has a number of beneficial effects. Licensing allows firms easy access to new technology which they can use and improve. Licensing thus enables a wider spectrum of the general public to benefit from the technology. It also encourages innovative activity among smaller firms who would not be able to manufacture the technology throughout the duration of the entire Community. However, patent licensing agreements might raise concerns about partitioning of national markets because they can impose territorial restrictions.[131]

In recognition of the potential benefits, the Commission adopted a group exemption for patent licensing such agreements in Commission Regulation 2349/84.[132] With regard to territorial protection, the regulation protects both the licensor and the licensee against any competition from the other party throughout the agreement. It also protects the licensee against competition from other licensees for up to five years from the time the product is first put on the market in the Community. The territorial protection exemption is only subject to two conditions: (1) that the licensed patents are still in force in the protected territory; and (2) that the licensee manufactures the licensed product or has it manufactured by a subsidiary or subcontractor.[133] The Commission justifies territorial exclusivity for patent licensing by emphasizing the possibility of parallel imports from outside the territory.[134] Unless the patent licensee seriously abused its position, it would be more expensive to import products over long distances because of increased transportation costs. In essence, this allowance grants the parties a windfall since they can generate more profits and avoid serious competition. The benefits for having a patent licensing exemption in terms of encouraging innovation must be thought to outweigh the anticompetitive behavior that the exemption creates.

131. *See generally* Norbert Koch & Franz Froschmaier, *The Doctrine of Territoriality in Patent Law and the European Common Market*, 9 IDEA 343 (1965).

132. EEC COMPETITION POLICY IN THE SINGLE MARKET, *supra* note 113, at 40.

133. *Id.* at 41.

134. David H. Marks, *Patent Licensing and Antitrust in the United States and the European Economic Community*, 35 AM. U.L. REV. 963, 975-76 (1986). For a discussion of the purposes of territorial limitations in licensing, see Demaret, *supra* note 18, at 44-55.

By contrast, Community law treats territorial restrictions dealing with sales to distributors differently from territorial restrictions involving the issuance of patent licenses to manufacturers.[135] General territorial restrictions concerning distributions within a single member state can be legal, provided they do not infringe upon Article 85(1). However, those territorial restrictions concerning distributions of any industrial property, which are based on national borders within the Community, are per se illegal because they inhibit trade between the member states.[136] These types of agreements are a paramount violation of Article 85 and of the goal to form a common market.[137] Therefore, the Court of Justice announced a test that considers several factors to determine whether an agreement violates Article 85 and Treaty goals.[138] First, "[t]he agreement must have as its object of effect the prevention, restriction or distortion of competition."[139] Second, one must consider the consequences of the agreement to determine whether it in fact prevents, restricts, or distorts competition to an appreciable extent. Considering this second factor, the Court of Justice stated:

> In this respect special attention should be given to the severity of the clauses granting the exclusive dealership, the nature and quantity of the products covered by the agreement, the position of the grantor and of the concessionnaire on the market for the products in question and the number of parties to the agreement . . . .[140]

The Court of Justice generally followed this approach in declaring a territorial restriction illegal in *Miller International Schallplatten GmbH v. Commission*.[141] Miller produced records, tapes, and cassettes. Miller appealed a Commission decision, which found that Miller infringed upon Article 85(1) by an exclusive dealing agreement that included prohibitions on the export of its products.[142] The Court concluded that the export prohibitions restricted

135. For a discussion of the benefits of such a distinction, see Demaret, *supra* note 18, at 57.

136. *See* Société Technique Minière v. Maschinenbau Ulm GmbH, 1966 E.C.R. 235, 251. The Court of Justice has also decided that certain restrictions inherent in distribution franchises fall outside of Article 85(1). The restrictions are necessary to achieve the legitimate objectives of the franchise system. *See* Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgalis, 1986 E.C.R. 353, 381-85. It may be significant to note however, that the Court of Justice in Pronuptia did not engage in economic analysis in reaching its decision. *Id.*

137. The Commission will also not tolerate clauses which provide a disincentive to export goods to another member state. *See, e.g.*, A. Zanussi, Commission of the European Communities, 1978 O.J.(L 322) 36; Re the Guarantee Given by Industrie A. Zanussi SpA, 1979 1 C.M.L.R. 81.

138. *Société Technique Minière*, 1966 E.C.R. at 251.

139. *Id.*

140. *Id.* at 251-52.

141. 1978 E.C.R. 131.

142. *Id.* at 146. Miller concluded the agreement with the undertaking Sopholest of Strasbourg for the distribution of Miller's products in the Alsace-Lorraine region of France. The majority of Miller's sales are to distributors in Germany. *Id.* at 147. Alsace-Lorraine lies on the border of Germany, so it is likely that Miller feared the export of its products into Germany by Sopholest, as Miller charged its German customers higher prices. Miller also applied conditions upon its German distributors, demanding that they refrain from exporting the products. *Id.* at 147-48.

competition under Article 85(1) and that Miller had a sufficient position in the market to cause the Commission to act.[143] Thus, Miller's agent could not fall within the de minimis exception of 85(3).[144] The clauses would certainly affect trade between member states. The Court of Justice stated:

> In prohibiting agreements which may affect trade between member states and which have as their object or effect the restriction of competition Article 85(1) of the Treaty does not require proof that such agreements have in fact appreciably affected such trade, which would moreover be difficult in the majority of cases to establish for legal purposes, but merely requires that it be established that such agreements are capable of having that effect.[145]

Consequently, the Court of Justice dismissed Miller's application.

One can reconcile the different treatment accorded territorial restrictions in patent licensing and sales to distributors under Community law. The Community believes that patent licensing provides such a large benefit that it outweighs the anticompetitive nature of the territorial restrictions. By contrast, it sees no redeeming features in allowing agreements to limit free trade of goods between member states. Doing otherwise would directly contravene the principles of a common market.

D. Summary

During the last twenty-five years, the Court of Justice has consistently used a strict, but rational aproach to Article 36. Its narrow construction of the Article ensures that the member states will not be able to abuse the rights granted under Article 36 to prevent the establishment of a real common market.

In his opinion in *Sterling Drug*, Advocate General Trabucchi advanced an approach that would balance Community and national law "to ascertain whether national rules can be given exceptional treatment under Article 36."[146] The interpretation given Article 36 by the Court of Justice reflects its desire to achieve this balance between Community law and national law. The use of the proportionality principle exhibits such an approach. Additionally, through its decisions involving Article 36 and Articles 85 and 86, as well as the exhaustion of rights principle, the Court of Justice accommodates competition policy and industrial and commercial property rights.

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143. *Id.* at 148-50. The Court found that Miller's share of the total German market for sound recordings averaged 5.35% for the years 1970-1975. Yet, as the court noted, if one considered bargain-range recordings and recordings for children, Miller's share of the market would be appreciably higher. *Id.* at 149. Clearly, it makes a significant difference how the Court chooses to define the market.

144. By contrast, in Völk v. Vervaecke, 1969 E.C.R. 295, 306; 1969 C.M.L.R. 273, 282, the Court of Justice held that an agreement does not fall within the prohibitions of Article 85(1) when the parties have such a weak market position that the effect of the agreement on the market is insignificant.

145. *Miller Int'l*, 1978 E.C.R. at 151.

146. *Sterling Drug*, 1974 E.C.R. at 1173.

This approach is not a leap of faith by the Court of Justice. It is reasonably based on an understanding of the goals of the Treaty of Rome and the means by which they are to be accomplished. Article 36 itself appears to call for a balancing test through the juxtaposition of its two sentences. The first sentence allows for exceptions to the free movement of goods, whereas the second sentence states that this right exists, providing it is not abused. By using a balancing approach, the Court of Justice can give itself discretionary power to determine a case fairly on its individual facts. It allows the Court of Justice great flexibility and thus also lends the Court credibility. The decisions are politically palatable to the member states because they preserve their rights within a common market. In this way, the Court of Justice can increase its role in resolving disputes and improve chances that its authority will be respected.

In order to gain a better understanding of the manner in which the Court of Justice has dealt with industrial and commercial property rights under Article 36, it is useful to look at the American approach. Community law has adopted many of the doctrines used in the American legal system. Yet, the unique evolution of the Community requires it to accept these legal principles selectively.

III.
THE AMERICAN EXPERIENCE AS A COMPARISON

A. Discrimination Against Interstate Commerce

The American experience in this area has been quite different from that of Europe. While the United States has had a federal system for more than two hundred years,[147] federalism is still in its evolutionary stages in Europe. Thus, it is not surprising that the American and European systems are not completely symmetrical.

The goals of American law in this domain have evolved over time. Today, a significant concern in American jurisprudence is the encouragement of free trade in interstate commerce. The Constitution gives Congress the power to regulate commerce with foreign nations and among the states.[148] The U.S. Supreme Court has interpreted this to mean that federal laws will be upheld if there is any rational basis upon which Congress could have found some relation to interstate commerce.[149] Moreover, Congress has the right to impose

147. For an excellent discussion of the principles and history of American federalism, see Andrzej Rapaczynski, *From Sovereignty to Process: The Jurisprudence of Federalism After Garcia*, 1985 SUP. CT. REV. 341.

148. U.S. CONST. art I, § 8.

149. NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1, 36-37 (1937). The case involved the NLRB's attempt to prevent Jones & Laughlin from engaging in unfair labor practices by firing employees for union activity. As 75% of its manufactured product would be sent out of Pennsylvania, the Court concluded a labor stoppage would have a substantial effect on interstate commerce. *Id.* at 41. Today, it is unclear if one must prove whether there is a "substantial effect" on interstate commerce. *See* Hodel v. Va. Surface Mining, 452 U.S. 264, 281-82 (1981).

conditions on activities that affect interstate commerce.[150] The Supreme Court will hold a state regulation unconstitutional if the state discriminates against interstate commerce or places an undue burden on interstate commerce. A state also may not tax in a way that discriminates against interstate commerce.[151]

American law under the commerce clause has successfully aided national integration without unduly burdening the sovereign rights of the states.[152] One major reason for this success is the free mobility of capital in the United States.[153] The mobility of capital creates pressure toward interstate harmonization and deregulation as investors are free to conduct business in several states with few restrictions. The European Commission has also recognized the need to liberalize capital movement policies to help achieve a common market.[154]

By its very nature as a group of twelve different nations with their own legal systems, however, the European Economic Community has certain problems pertaining to intellectual property that the United States does not. First, the Community must deal with all the varying national laws concerning industrial and commercial property, while the United States protects intellectual property rights at the national level.[155] Additionally, many of the national governments within the Community artificially keep the prices of certain goods lower than they would be in a free market.[156] For example, most of the cases examined by this paper involve imports of pharmaceuticals. Disputes arose because prices of pharmaceuticals varied widely from country

150. *See* United States v. Darby, 312 U.S. 100, 118 (1941). In Darby, the Supreme Court upheld the Fair Labor Standards Act of 1938, which set minimum wages and maximum hours for employees engaged in the production of goods for interstate commerce. *Id.* at 111.

151. *See, e.g.,* Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 270-71 (1984); Armco, Inc. v. Hardesty, 467 U.S. 638, 642 (1984); Westinghouse Elec. Corp. v. Tully, 466 U.S. 388, 403 (1984); Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue, 483 U.S. 232, 240-41 (1987).

152. Cass R. Sunstein, *Protectionism, the American Supreme Court, and Integrated Markets, in* 1992: ONE EUROPEAN MARKET? A CRITICAL ANALYSIS OF THE COMMISSION'S INTERNAL MARKET STRATEGY 127, 140 (Roland Bieber et al. eds., 1988).

153. *Id.* at 129.

154. Commission of the European Communities, *Completing the Internal Market - White Paper from the Commission to the European Council*, Part Two, Section V (1985).

155. The Community has recognized the need to develop harmonized industrial property laws, a uniform patent system, and a unitary trademark. *See infra* IV.

156. Peter Marsh, *Towards a Single Europe: Bitter Pills to Take*, FIN. TIMES, Nov. 17, 1988, at 12.

to country in the Community, creating lucrative opportunities for importers.[157]

As many member states have national health care plans, the public health agencies are the largest buyers of pharmaceuticals in the EEC and can exert a great deal of influence on pricing.[158] In the United Kingdom, for example, the Health Department buys all pharmaceuticals from local companies, even if it is possible to import them at lower prices.[159] The Health Department operates a complex scheme whereby it agrees with pharmaceutical companies on their allowed annual profits. Any excess profits are to be paid to the Department of Health.[160]

Artificial government pricing led to the dispute in *Sterling Drug*, in which Dutch pharmaceutical prices followed the market and the British government kept prices artificially low.[161] Moreover, Sterling Drug pointed out to the Court of Justice that exchange rate changes accounted for sixty percent of the price differences.[162] Until the Community is able to solve these problems, a true common market cannot exist.

Because Federal courts in the United States strictly enforce Congressional attempts to prohibit individual states from discriminating against interstate commerce, and because there is a uniform currency, the problem of extreme price discrepancies does not exist in the United States. Despite these basic differences, however, the doctrines discussed above have relevance in U.S. law. Thus, this article next examines how the American legal system has dealt with these doctrines.

157.

Comparative Price Index for Pharmaceuticals (Spain as baseline):

Ireland	254
West Germany	251
Netherlands	230
United Kingdom	201
Belgium/Lux.	132
Italy	119
France	113
Portugal	107
Spain	100

Source: Peter Marsh, *A Prescription for Complications*, FIN. TIMES, Oct. 15, 1988, at 6. Marsh expects these price differentials to decrease after 1992 through new directives by the Commission.*Id.*

158. *Id.*

159. *See* Marsh, *supra* note 156, at 12.

160. *See* Marsh, *supra* note 157, at 6. The profit agreement takes into account research and development costs, in order to act as an incentive for pharmaceutical companies to invest ample capital in manufacturing new drugs. *Id.*

161. *Sterling Drug*, 1974 E.C.R. at 1154.

162. *Id.* at 1159.

B. Exhaustion of Rights Principle

The U.S. Supreme Court first introduced the concept of the exhaustion of rights principle with respect to patents in *Adams v. Burke*.[163] The case concerned a patent received by Merrill & Horner for an improvement in coffin lids.[164] The Court held that once the patentee sells the invention, he receives consideration for its value and the invention is no longer within the monopoly of the patent.[165] The purchaser could then use the invention without restriction, even in an area beyond the ten mile radius of Boston. The patentee could not thereafter divide the country into territorial segments in terms of use of the invention. Once lawfully sold, there was no restriction on its use.[166] The Supreme Court followed this opinion in a series of cases, indicating acceptance of the exhaustion doctrine in American law.[167]

C. The Gray Market

One variation of the exhaustion of rights principle can be found in the concept of the gray market. The gray market typically originates when a manufacturer in one country sells its products to third parties who import it legally, whereby the products compete with the manufacturer's licensed distributors. The gray market legally permits unauthorized sellers to purchase goods for less than the price paid by authorized dealers, thus allowing them to undercut authorized dealers. The goods sold have actually been produced by the manufacturer, but the distribution is unauthorized in the sense that the manufacturer has not explicitly authorized the sale. Usually, a manufacturer will establish, through contractual agreement, an exclusive territory for its

163. 84 U.S. (17 Wall.) 454 (1873).

164. The patent granted the company exclusive right to make, use, and license to others to use the improvement. Merrill & Horner assigned the exclusive right to use the invention within a ten mile radius of Boston, Massachusetts, which they subsequently assigned to Adams. Adams asked for an injunction against the use of the invention by an undertaker, Burke, in the town of Natick. Burke purchased the coffin within the ten mile radius of Boston. The town of Natick is located seventeen miles from Boston and thus outside of the radius. *Id.* at 453-54.

165. *Id.* at 456.

166. *Id.* at 456-57. The Supreme Court later applied this doctrine to copyright in Bobbs-Merrill Co. v. Straus, 210 U.S. 339, 350 (1908). For an exception to the exhaustion doctrine, see United States v. Gen. Elec. Co., 272 U.S. 476 (1926). General Electric licensed Westinghouse to make and sell patented electric lamps. The license placed a price restriction on Westinghouse. *Id.* at 481-82. The Court upheld the price restriction, distinguishing the case on the basis that General Electric licensed Westinghouse to both manufacture and sell the lamps. *Id.* at 490. If it had been merely a license to sell, a price restriction would be prohibited.

Marks explains the obvious difficulty with this distinction through his discussion of the following case. *See* Marks, *supra* note 134, at 979. In United States v. Unvis Lens Co., 316 U.S. 241 (1942), the Supreme Court struck down a price restriction on the resale of a patented lens. The Court determined that the restriction did not fall within the rule announced in *General Electric*, even though the purchasers of the lens were required to engage in further manufacturing of the blank lens before it could be resold. *Id.* at 252. The Court relied on the *Adams* case in its decision. *Id.* at 250.

167. *See, e.g.*, Hobbie v. Jennison, 149 U.S. 355, 362 (1893); Keeler v. Standard Folding Bed Co., 157 U.S. 659, 666 (1895); Bauer & Cie v. O'Donnell, 229 U.S. 1 (1913); Ethyl Gasoline Corp. v. United States, 309 U.S. 436, 443 (1940).

dealers, which limits where they can sell.[168] In this way, authorized dealers will not compete with one another.

The basis for the gray market can be found in the exhaustion of rights principle, in that once the manufacturer sells the product, the purchaser can do with it as it pleases. It is a slight variation in that it involves infringement on intellectual property rights by imports from another country. Thus, the gray market is not covered by the case law concerning interstate commerce.

The gray market for parallel imports into the United States has grown dramatically in recent years, amounting to ten billion dollars in 1985.[169] Gray market imports are generally brand name luxury goods of high quality, particularly luxury automobiles.[170] The importers can take advantage of exchange rates and distribution efficiencies to provide price savings for consumers.[171] However, the gray market harms the U.S. trademark owners by undercutting their prices. By free riding on the established trademark, the importers deprive the trademark owners of the benefits of their investments. The gray market also may harm consumers because the goods they purchase usually lack the quality controls or warranties of legitimate goods.[172] Consumers, therefore, have the option of purchasing gray market goods at a lower price in exchange for some degree of risk. Moreover, some commentators point out that gray markets arise in the first place because trademark owners price discriminate against U.S. consumers.[173]

There have been recent developments in American case law regarding gray market imports. Gray market imports may enter the United States under Customs Service regulations if they meet the common control or authorized use exceptions:[174]

> (1) Both the foreign and the U.S. trademark or trade name are owned by the same person or business entity; (2) The foreign and domestic trademark or trade name owners are parent and subsidiary companies or are otherwise subject to common ownership or control . . . ; or (3) The articles of foreign manufacture bear a recorded trademark or trade name applied under authorization of the U.S. owner.[175]

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168. Robert J. Staaf, *The Law and Economics of the International Gray Market: Quality Assurance, Free-Riding and Passing Off*, 4 INTELL. PROP. J. 191, 192 (1988).

169. J. Thomas Warlick IV, *Of Blue Light Specials and Gray-Market Goods: The Perpetuation of the Parallel Importation Controversy*, 39 EMORY L. J. 347, 350 (1990).

170. *Id.* at 351.

171. As long as the dollar remains weak, the gray market will likely decrease. In 1985, when the dollar was at its highest levels, gray market sales of foreign cars amounted to 65,000 units. By 1987, with a significantly weaker dollar, sales slumped to 12,000 units. *See* U.S. NEWS & WORLD REPORT, June 13, 1988, at 8.

172. Theodore H. Davis, Jr., *Applying Grecian Formula to International Trade: K Mart Corp. v. Cartier, Inc. and the Legality of Gray Market Imports*, 75 VA. L. REV. 1400-01 (1989).

173. *Id.* at 1419. *See generally*, Robert J. Staaf, *International Price Discrimination and the Gray Market*, 4 INTELL. PROP. J. 301 (1988).

174. Raymond R. Mandra, *K Mart Corp. v. Cartier, Inc.: Is Continued Gray Market Importation a Result of Gray Statutory Language or Judicial Legislation?*, 10 PACE L. REV. 245, 251-55 (1990).

175. 19 C.F.R. § 133.21 (1987).

In *K Mart Corp. v. Cartier, Inc.*,[176] the Supreme Court examined the validity of these exceptions. The *K Mart* case resulted from a suit filed by the Coalition to Preserve the Integrity of American Trademarks (COPIAT) "seeking declaratory relief against the validity of the Customs Service regulations, 19 C.F.R. § 133.21 (c)."[177] Cartier was a member of COPIAT.[178] Thereafter, K Mart and 47th Street Photo, two major discount retailers, both of whom participate in gray market importation, joined the action as intervenors.[179]

The Court upheld the common control exceptions, but struck down the authorized use exception.[180] The common control exceptions cover approximately ninety percent of gray market imports, so the Court's decision will not have such a great impact on the gray market.[181] It will only help those American firms that license foreign firms to use their trademark.

The Third Circuit recently applied the *K Mart* decision in *Weil Ceramics & Glass, Inc. v. Dash*,[182] offering a compelling defense of the *K Mart* decision. Weil Ceramics & Glass ("Weil") is the wholly owned subsidiary of Lladro, which manufactures porcelain in Spain.[183] Each piece bears the trademark, "LLADRO."[184] Weil obtained a U.S. registered trademark for LLADRO and became the exclusive distributor of the porcelain. The Jalyn Corporation purchased the porcelain in Spain and imported it into the United States, without the consent of Weil. Weil then sought declaratory and injunctive relief against Jalyn.[185]

The Third Circuit court applied *K Mart* to this case and found that the facts placed *Weil* within the case two scenario permitted in *K Mart*.[186] Thus,

176. 486 U.S. 281 (1988). The Supreme Court noted that gray market imports typically arise in three contexts. First, a domestic firm purchases the exclusive right to register and use the trademark of a foreign firm and sells the products of the foreign manufacturer in the United States. The foreign firm may sell its products to a third party, who parallel imports the products into the United States. Second, a foreign manufacturer authorizes a domestic subsidiary to register the U.S. trademark for its goods. When the foreign firm sells its products abroad to a third party who parallel imports the products into the United States, the firm has inadvertently created a gray market. A variation of this scenario can occur when the trademark holder sells the products abroad and a third party imports them back into the United States. Third, a domestic holder of a trademark authorizes an independent foreign manufacturer to apply the trademark to its products, with an exclusive right to distribute the products in a certain foreign geographic area. A third party buys the products and imports them into the United States. *Id.* at 286-87. The Court overturned only the legality of the case three scenario.

177. Mandra, *supra* note 174, at 258.

178. *Id.*

179. *Id.*

180. *Id.* at 259. The Court did not address the possible limits of a private cause of action held by trademark owners against gray marketers. A Federal Circuit Court had upheld this private cause of action a few years earlier in Vivitar Corp. v. United States, 761 F.2d 1552 (Fed. Cir. 1985).

181. Davis, *supra* note 172, at 1397.

182. 878 F.2d 659 (3d Cir. 1989).

183. *Id.* at 662.

184. *Id.*

185. *Id.*

186. *Id.* at 666.

Weil could not prevent the parallel importation of porcelain by Jalyn. Further, the court found that the *K Mart* decision followed the statutory intent of Congress. It determined that Congress sought to protect the consumer against deception and to protect the trademark holder's investment and that these goals were not undermined by the importation of genuine goods by Jalyn. The court stated that the only injury it perceived Weil endured "is the uncompensated for benefit that its advertisement and promotion of the trademark confers upon Jalyn, . . . [however], that 'injury' is not completely uncompensated because Weil's parent corporation profits by the sale of Jalyn abroad."[187] The Third Circuit decision rationally explained the policy for allowing gray market imports, as the injury to Weil was low and the benefit to consumers was high.

While the United States has legitimized the gray market, the Community appears to have adopted a protectionist policy towards the gray market. In *Polydor Ltd. and RSO Records Inc. v. Harlequin Record Shops Ltd. and Simons Records Ltd*,[188] the Court of Justice held that if the right holder licenses a third party to manufacture and market the product in a non-member state, he can restrict those goods from being imported back into a member state where it is protected. RSO Records owned the copyright to sound recordings by the musical group, the Bee Gees. Polydor was the exclusive licensee for those recordings in the United Kingdom. RSO Records licensed two other companies to manufacture and sell the recordings in Portugal.[189] Harlequin Records and Simons Records imported the Portuguese manufactured records into the United Kingdom below the current prices, without the consent of Polydor or RSO.[190]

The Court of Justice refused to apply the same interpretation of Articles 30 and 36 to goods coming from non-member states. Even though the free trade agreement between the Community and Portugal contained clauses equivalent to Articles 30 and 36, the Court believed that the purpose of the agreement was not the same as that of the Treaty.[191] According to Advocate General Rozès, such prohibition can be tolerated because the "unity of the common market is not placed in jeopardy."[192]

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187. *Id.* at 672.

188. 1982 E.C.R. 329. Although not gray market cases, the *EMI Records* cases basically led toward decisions like *Polydor*. Through its decisions in *EMI Records* the Court of Justice legitimized the concept of discriminating against goods from non-Community countries.

189. At that time, Portugal was not a member state in the Community.

190. *Polydor*, 1982 E.C.R. at 344-45.

191. *Id.* at 349. Intervening governments pointed out that the agreement resembled the type of relationships established in agreements of the EEC with seven member states of European Free Trade Association (EFTA) and Cyprus, Israel, Malta, Spain, Yugoslavia, and Turkey. *Id.* at 340. Moreover, two EFTA countries, Austria and Switzerland, had refused to read the exhaustion principle into the free trade agreements between their countries and the Community. *Id.* at 354. *See also* Deutsche Grammophon v. Firma Pop Import, 1982 1 C.M.L.R. 137, for a similar interpretation of the free trade treaty between the Community and Israel.

192. *Polydor*, 1982 E.C.R. at 355.

This view can be explained by the concern of member states that an extension of Court of Justice case law relating to Community trade to imports of third countries, who would not necessarily reciprocate, could have a detrimental effect on the development of intra-Community trade.[193] Member states might fear that further trade liberalization could actually improve the competitiveness of third country imports into the Community, at the expense of products manufactured in the Community. The facts in *Polydor* could probably be analogized to the case three type of gray market imports disallowed by the U.S. Supreme Court in *K Mart*. However, there is no indication that the case one or case two type of gray market import would be allowed. In fact, the Community would likely apply the same analysis used in *Polydor* and *EMI Records* to restrict these imports, as they do not affect trade between member states.

The attitude of the Court of Justice and the Commission on this matter indicates that these institutions do not believe in the principle of world-wide free trade, but only in free trade within the Community. The *Polydor* decision shows that the Court of Justice will "restrict the exercise of industrial property rights and copyrights only when this is necessary to achieve the superior goal of the Community, namely to integrate the national markets in a uniform internal market."[194] Since Community law is not affected by gray market cases, national trademark laws will determine whether imports can be restricted.[195] These laws will vary from country to country. Some member states, such as Germany, actually recognize the principle of international exhaustion of rights in their laws and would prohibit the restrictions allowed by the Community in *Polydor*.[196]

The Community's protectionist response to gray market imports implies that it feels threatened by these imports. This fear indicates a lack of confidence within the Community of either its ability to attain the goal of a common market or maintain the political support of the member states. Accepting a common market within the Community would certainly be more politically palatable to the member states if there were an assurance that the floodgates would not be opened for free trade with third countries. Such an interpretation would also explain the contrary view of the United States in permitting gray market imports. The United States is secure in its single market, so that it can adopt liberal trading policies that benefit consumers. However, once the Community has harmonized industrial property laws, there

193. *Id.* at 354.

194. Friedrich-Karl Beier, *Industrial Property and the Free Movement of Goods in the Internal European Market*, 21 IIC 131, 157 (1990).

195. *Id.*

196. *Id.* at 157-58. Beier explains that "the principle of international exhaustion means that the Common Market cannot be shielded with the aid of national trademark laws against the import or re-import of genuine goods manufactured abroad by the trademark owner, his licensees or related companies, so that it is impossible, or at least difficult, to adopt and operate a separate price and distribution policy for the Common Market. This should benefit exporters in third countries, as well as importers and consumers in the Common Market." *Id.* at 158-59.

will be less need to discriminate against gray market goods. The member states will be secure enough in their own common market, so that they can tolerate gray market imports. Once these uniform laws have been achieved, the Community should follow the lead of the United States and liberalize its trading laws with other nations. European consumers should have the option to purchase gray market goods at lower prices in exchange for some risk in the quality of those goods. Further, allowing gray market goods should encourage the official distributors to lower their own prices in order to compete, benefitting all consumers.

D. Territorial Restraints

In the United States, territorial restrictions on patent licensing are legal, unless they are structured unreasonably and restrain competition.[197] Section 261 of the Patent Code states that a patentee may "grant and convey an exclusive right under his application for patent, or patents, to the whole or any specified part of the United States."[198] The issue has not actually been examined in depth; courts have merely assumed that such arrangements are legal.[199] It is possible that the historical nature of the patent grant implies an inherent right to have horizontal territorial restrictions and field of use restrictions. If this is true, there may be a basic conflict between patent and antitrust law.[200] For the purposes of this article, it can be assumed that territorial restrictions through a patent license are considered legal.

By contrast, there has been extensive legal analysis in the United States concerning distribution agreements with vertical territorial restraints. In *Continental T.V. Inc. v. GTE Sylvania Inc.*,[201] the Supreme Court established a rule of reason analysis in these territorial restriction cases. The Court upheld a distribution arrangement by Sylvania whereby it would determine how many dealers it would sell its products to in a given geographic area. Through this arrangement, Sylvania increased its market share to five percent, ranking the company eighth among color television manufacturers in

197. LAWRENCE ANTHONY SULLIVAN, HANDBOOK OF THE LAW OF ANTITRUST 529 (1977).

198. 35 U.S.C.A. § 261 (West, 1984).

199. *See, e.g.*, Brownell v. Ketcham Wire & Mfg. Co., 211 F.2d 121, 128 (9th Cir. 1954) ("It is a fundamental rule of patent law that the owner of a patent may license another and prescribe territorial limitations."); *see also* Dunlop Co. v. Kelsey-Hayes Co., 484 F. 2d 407, 417 (6th Cir. 1973).

200. SULLIVAN, *supra* note 197, at 531-32. *See generally* Richard M. Buxbaum, *Restrictions Inherent in the Patent Monopoly: A Comparative Critique*, 113 U. PA. L. REV. 633, 658-61 (1965) (Professor Buxbaum points out the uselessness of this line of inquiry and suggests a more pragmatic approach. He proposes that one analyze the particular positions of the parties, relative to one another. This more specified analysis might demonstrate that the actual patent license itself creates a greater source of monopoly power that would not have been possible had the patentee not have had the ability to license with a territorial restriction).

201. 433 U.S. 36 (1977).

the country.[202] The Court found that while the restrictions restrained intrabrand competition, they may have enhanced interbrand competition by allowing the manufacturer to gain distribution efficiencies and market share in an oligopolistic market. The Court then concluded that it could best balance these competing interests through a rule of reason.[203] Such an analysis would consider the following factors: (1) whether the arrangement is likely to have a permanent negative effect on interbrand competition; (2) whether the restraint has redeeming social value; (3) whether there is intrabrand competition; (4) whether the manufacturer has great market power; and (5) whether the arrangement is absolutely necessary to allow the company to stay in business.[204]

Some commentators have questioned whether a court is actually capable of dealing with this type of open ended analysis, which necessarily involves a great deal of economics. According to the argument, courts will have to simplify complex facts in order to balance the competing interests, so that results will likely be inconsistent.[205]

Rather than adopt the rule of reason analysis of *Sylvania*, the Court of Justice appeared to hold that all exclusive territorial clauses affecting trade between member states were per se illegal in *Miller International*. These two varying approaches can be understood by simply noting the different positions of the United States and the Community in terms of establishing free movement of goods between the member states. The United States no longer has restrictions on interstate trade, thus vertical territorial restrictions can be tolerated. The Community, on the other hand is desperately trying to overcome centuries of trade restrictions between different nations. Thus, distribution agreements with territorial restrictions within single nations are tolerated, whereas those same restrictions, based upon borders between member states, are considered abhorrent. Such arrangements directly inhibit free movement of goods among the member states, prolonging the creation of a common market. It is therefore reasonable for the Court of Justice to outlaw these restrictions.

IV.
THE PROMISE OF HARMONIZATION

The efforts made by the Community to achieve a true common market have been remarkable. The Community has encountered a great deal of difficulty, however, with respect to industrial and commercial property rights because member states consider them to be part of national rights. While the Court of Justice has adopted various doctrines to ensure that trade between

202. *Id.* at 38-39.
203. *Id.* at 57-59.
204. *Id.*
205. HERBERT HOVENKAMP, ECONOMICS AND FEDERAL ANTITRUST LAW 271 (1985).

member states is not inhibited to a great extent, right holders are still able to exert some control over the movement of goods.

The ultimate solution to the problems encountered by the Community in protecting industrial and commercial property could be found through harmonized laws (i.e., unitary patent and trademark registration and copyright protection throughout the Community). In this way, the Community could move towards a single system for protecting these property rights, similar in function to that of the United States. With unitary systems for protecting industrial property, the current national laws would no longer serve to discriminate between national markets within the Community.

In fact, there have been several recent efforts to harmonize and unify Community intellectual property laws. In 1975, the member states signed the Community Patent Convention in order to enable an applicant to obtain a single patent applying throughout the Community.[206] The member states signed a final version of the treaty in 1989.[207] However, while the Convention has been signed by every member state, it has not yet been ratified by all of them.[208] The Convention will create a uniform patent system in the EEC and the possibility of obtaining a Community patent.

There has also been a proposal to set up a uniform trademark system, although the means to achieve this are quite different.[209] The Council of Ministers plans to pass a trademark regulation.[210] It would create a unitary trademark and enable a company to register a trademark in all member states

206. OLIVER, *supra* note 64, at 155.

207. Agreement Relating to Community Patents, of Dec. 15, 1989 O.J. (L 401) 32.

208. Denmark and Ireland have been unable to ratify the treaty. Denmark failed because a five-sixths majority is required under the Danish Constitution, while in Ireland there are doubts as to whether a constitutional amendment is required. Christian Hilti, *The Future European Community Patent System and Its Effects on Non-EEC-Member States*, 18 AIPLA Q. J. 289, 294 (1990). An additional protocol attached to the final version of the agreement would allow the treaty to enter into force without ratification by every member state. *Id.* at 295-96. The Convention would thus be ready to take effect during the completion of the internal market at the end of 1992. *Id.*

209. *See* 3 COMMISSION OF THE EUROPEAN COMMUNITIES, COMPLETING THE INTERNAL MARKET: CONDITIONS FOR BUSINESS COOPERATION, 38-40 (1990) [hereinafter COMPLETING THE INTERNAL MARKET].

210. In this way, the Council can avoid ratification problems. They can use part six, Article 235 of the EEC Treaty, to circumvent the provision in Article 222. Article 222 states: "This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership." Article 235 states: "If action by the Community should prove necessary to attain, in the course of the operation of the common market, one of the objectives of the Community and this Treaty has not provided the necessary powers, the Council shall, acting unanimously on a proposal from the Commission and after consulting the Assembly, take the appropriate measures." EEC TREATY, *supra* note 1, art. 235.

in a single application. There is already a harmonization directive on trademarks to harmonize trademark law at the national level.[211] The deadline for implementation of the directive is December 28, 1991.[212]

Finally, there are even attempts to harmonize copyright law. This goal, however, will not be achieved for many years as there is no consensus on several important issues.[213] These are all positive steps toward integration that should be encouraged.

V.
CONCLUSION

The Court of Justice has been able to guide the Community in the direction of a common market through the adoption of certain reasonable legal doctrines, such as those we examined in connection with Article 36. The paramount concern in the case law on Article 36 has certainly been the limitation on protectionism by individual member states. The Court of Justice has maintained vigilance against attempts to partition the common market. Nevertheless, the Court of Justice has not rendered the national industrial and commercial property rights completely useless. Rather, as Professor Gormley explains, its approach:

> represents the Court's consistent determination to ensure that the member states respect and comply with the obligations stemming from the Treaty, a Treaty concluded for an unlimited period, on a firm basis of equality and of reciprocity. The benefit of access to the markets of other member states which the Treaty confers, brings with it, of course, obligations. Thus, the Court has been concerned to ensure that private parties do not attempt to use the first sentence of Article 36 to attempt to recreate the protectionist barriers which the member states have undertaken to remove.[214]

The exhaustion of rights doctrine has been widely accepted in the Community. In fact, Article 32 of the Community Patent Convention actually adopts the exhaustion of rights principle for Community patents. Article 81

211. First Council Directive of December 21, 1988, to Approximate the Laws of the Member States Relating to Trademarks (Trademark Harmonization Directive), 1989 O.J. (L 40) 32. One provision in the directive applies a strict approach to the non-use of trademarks. If, within five years following the registration of the trademark, the right holder has not put the trademark to genuine use, the privilege will be revoked, unless there are proper reasons for non-use. *Id.* at 5, 6. Additionally, the privilege will be revoked if the trademark "has become a common name in the trade for a product or service in respect for which it is registered" or if it is liable to mislead the public. *Id.* at 6.

212. *See* COMPLETING THE INTERNAL MARKET, *supra* note 209, at 41.

213. *Id.* The *Green Paper on Copyright* points out that in the realm of copyright, there still exist some undecided issues. For example, the cross-frontier transmission of broadcasts, which were at issue in the *Coditel* case, have yet to be fully dealt with in legislation. Additionally, the Court of Justice has not ruled on whether one could place a restrictive condition on the copyright goods placed on the market. Such restriction might state "Not for sale in . . . " or "Not for export." The Court would likely rule that such an indication does not form part of the essential function of copyright in goods lawfully placed on the market, and thus cannot be used to prevent the import of certain goods. *Green Paper on Copyright*, *supra* note 13, at 152.

214. GORMLEY, *supra* note 34, at 221.

of the Community Patent Convention applied the exhaustion of rights principle to national patents. Article 81(c) asserts the exception in cases which deal with compulsory licenses.[215] The Convention has had a great deal of influence on national laws, as these exhaustion of rights provisions have already been incorporated into the national laws of most member states.[216]

The Community must also make a greater effort to reduce the price differentials of certain goods, particularly pharmaceuticals. Only by removing price supports for these products can a true common market exist. The practices, explained above, which exist in the United Kingdom, for example, clearly discriminate against pharmaceuticals from other member states. The U.S. Supreme Court would certainly hold that these types of practices, if exercised in the United States, would violate the commerce clause. After 1992, many commentators expect the price differentials to gradually disappear. While action on this front is not immediately necessary, a solution must be found eventually.

It would be politically difficult for the Community to remove all of the obstructions to the common market at once, but until they do, full economic integration is not possible. Yet, the impressive speed by which the Community has moved towards economic integration indicates widespread support for the goal of a common market and provides hope that it will soon be achieved.

215. For the text of these provisions in the Community Patent Convention, see CAWTHRA, *supra* note 94, at 99.
216. *Id.* at 102.