

## THE FREE MOVEMENT OF GOODS POLICY V. NATIONAL PATENT RIGHTS

### Abstract

*From the approach of the European Court of Justice and its reasoning displayed above several points can be made, concerning the impact of the free movement of goods principle upon national patent rights:*

*Any action taken by a patent holder before a national court stemmed from his patent to pursue the cross-border movement of patented goods shall be sustained as long as it is conducted within the specific subject matter of patent rights.*

*The action in the national court to prevent the free trade, which exceeds beyond the scope of the patent's specific subject matter, shall be treated as a measure having equivalent effect to the quantitative restrictions on imports between Member States, thus prohibited by Article 28.*

*Article 28 is directly applicable, hence it can be relied upon by a defendant to a patent infringement action; the Article, therefore, overrides the national patent rights unless a claimant shows that the defendant's conduct is covered by the specific subject matter of the patent.*

*The specific subject matter of patent rights is limited by the European Court of Justice to the right of first sale of patented goods undertaken by a patent holder "either directly or by the grant of licences to third parties";<sup>1</sup> any further*

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<sup>1</sup> Centrafarm BV v. Sterling Drug Inc. [Quoted from S. Weatherill, *Cases and Materials on EC Law* (London, Blackstone Press Limited, 2001) p. 548].

*attempt of a patentee to control and restrain the circulation of such goods within the Common Market is not covered by the specific subject matter, therefore it shall not be upheld by a national court (Community-wide exhaustion of patent rights).*

*Article 28, thus, has its overriding effect where national law would otherwise empower the right-owner to prevent parallel importation;<sup>2</sup> apart from that, national patent law in each State alone determine the content and scope of the patent rights together with procedures and conditions for obtaining them "until there is a relevant harmonization Directive, or a Community right becomes a complete substitute."<sup>3</sup>*

*The appreciated scope of an exclusive patent licence is regulated by the Competition rules of the Treaty (Articles 81 and 82) prescribed to deal with private undertakings; the competition policy towards national patent rights is compatible with the free movement of goods policy (see the findings over the Maize Seed case covered within previous chapter).*

*Note also that the Community-wide exhaustion of patent rights is confined to regulate cross-border movement of commodities within the Common Market (including the EEA). It does not apply to circulation of patented goods between non-member states and the EU. Except industrial producers, consumers and parallel importers as vagaries of the conflict with the EU amid, here the issue is rather more complex, as different context, players and policies are involved; the issue is to be tackled with great consideration given to different and opposing interests that might occur within the World Trade Organization (WTO).<sup>4</sup> So far, however, the European industrial producers have pleaded for rule of non-exhaustion at the external boundaries of the Common Market corroborating the case by the fact that it could encourage the set-up of production and transfer of technology into the cheaper developing countries. Otherwise, the prospect would be hampered by consequent parallel importation from there. In addition, the EU would probably refrain from introducing international exhaustion unless it can secure a reciprocal move from other foreign trading partners.*

*However, for the purposes of this work it is enough to stress that in principle unless "an effective rule of Community law on the matter is adopted, the applicable rule is determined by the law of the country of import."<sup>5</sup>*

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<sup>2</sup> W. Cornish & D. Llewelyn, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*, (London, Sweet & Maxwell, 2003.) para. 18-03.

<sup>3</sup> *Ibid.*

<sup>4</sup> However, Agreement on Trade-Related Aspects of Intellectual Property Rights (WTO -TRIPS agreement) avoid addressing the issue of exhaustion of intellectual property rights, unless it can be deemed that it is covered by national treatment or most favored-nation treatment provisions (*Ibid.* para. 1-58)

<sup>5</sup> *Ibid.*

**Ključne reči:** prava intelektualne svojine, slobodan promet robe, komunitarno pravo, autorska i srofná prava.

**Key words:** intellectual property rights, free movement of goods, community law, copyrights and related rights.

## INTRODUCTION

The goal of intellectual property rights (IPR) is protection of economic application of ideas and information that are of commercial value. There are several classes of IPR, of which most notable are copyrights and related rights, patent rights, and trademarks, and accordingly each of them has its own distinct subject-matter and purpose. Nonetheless, what they have in common is that all of them are concerned with determining *types of conduct which may not be pursued without the consent of right-owner*<sup>6</sup>, thus they are dealt with by a broad analogy to property rights in tangible movables.

However, the aim of IPR is not to protect the actual possession in law by the possessor of intellectual property (IP), as in reality its holder is *anyone who has a knowledge or unmolested access to come into the knowledge of such property*<sup>7</sup>. Ideas and information are disseminated through means of communication and consequently each consumer is their possessor whether they desire it or not. Such diffusion the law is not able to control, nor would it be appreciated to do so. What it, actually, aims at is to establish the *system of bans*, in order to prevent others, but the legal proprietor of IP, to economically utilize upon it.<sup>8</sup> Thus if one cannot inhibit the possession of IP, it can preclude its *commercial use*. As a result intellectual property rights are *essentially negative*, meaning that they represent the authority of the right-owner to stop others from exploiting them. In other words, the right-holder is exclusively authorized to manufacture and to place into circulation goods or to perform services through which IP is materialized.<sup>9</sup>

The underlying objective is to shield and incite the creative effort and investment in capital and work by entrepreneurs, whom would be demoralized to do so, if they would be left to watch imitators *yielding without sowing* upon their accomplishments and thus to reward and encourage innovation. In other

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<sup>6</sup> W. Cornish & D. Llewelyn, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*, (London, Sweet & Maxwell, 2003.) para. 1-01.

<sup>7</sup> S. Marković, *Pravo intelektualne svojine* (Belgrade, Nomos, 2000) p. 23.

<sup>8</sup> *Ibid.*

<sup>9</sup> *Ibid.*, p. 26

words, the protection of IP is one of prerequisites for economical, cultural and technological development of each society.

Everything aforementioned refers especially to patent rights. Patents, as a type of IPR provide temporary protection to inventions, *i.e.* technological improvements, great and small (short-term patents), that are previously unrevealed (condition of novelty), under condition that they possess sufficient level of inventiveness and economical applicability. Likewise, other intellectual property rights patent supplies the right-holder with the *exclusive right (exclusivity)* to economically exploit (to manufacture and sell) its invention and at the same time exclude the others, *i.e.* competition in doing the same, within the term of its duration. Thereby, the patent gives to its right-holder capability to control the competition, as it prevents others from encompassing any form of the protected invention in their products and services. What differentiates patent rights from other sorts of IPR is the capacity of excessive market powers in hands of their proprietors that diminishes rivals in direct competition due to the advantages provided by their protected inventions.<sup>10</sup> The market power is bigger as the invention is more inventive. To be more specific, if the invention represents major technological breakthrough in certain area it will make the competition obsolete. That means that the patent owing to its exclusivity can provide the patentee with a monopoly, which intimidates competition and might distort workable competition.

National character of the IPR, and thus of patent rights, is their second crucial feature. Although, universal by their nature, nevertheless, intellectual property rights mainly derive under national law. Despite this, there is substantial number of multilateral agreements in existence, that cover different issues of IPR. Yet, all of them are confined only to condition, supplement and/or indirectly approximate national laws. They do not, however, create comprehensive supranational regime of IP and do not facilitate its protection. The same, more or less, stands for the patent protection. In reality, this means that if a patent-holder has protected his invention under law of Serbia & Montenegro this does not mean that he can rely upon it in Hungary. Before he would be able to do so, he must previously obtain the patent from Hungarian patent-granting authorities, save that his invention fulfils all the demands set by the Hungarian law. But, once a third party, independent from the right-holder tries to export commodities in which the alleged invention is

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<sup>10</sup> For example, unlike patent rights, trademarks "do not by themselves have the capacity to prevent a competitor from entering any market with his own products or services; they merely prevent him from annexing the protected mark in order to facilitate his market entry." [W. Cornish, *op.cit.*, para. 1-07].

materialized from Hungary into Serbia & Montenegro, in order to market them there, the patent-holder is entitled to invoke his exclusive rights under the local law and prevent their exportation and marketeering. This is so due to the *principle of territoriality* of patent law that arises from mentioned national character of IPR. As a result "*the right in each country is determined by the law of that country and it is independent of equivalent rights governing the same subject-matter in other countries and neither stands or falls with them.*"<sup>11</sup> This also means that "*the right only affects activities undertaken by others within the geographical territory for which it is granted.*"<sup>12</sup>

Therefore, *exclusivity* of the patent rights followed by their *territorial character* endows the proprietor with respective market powers that enables him to control commercial activities of his direct competitors within the market by using them as an instrument for preventing others to produce, distribute and sell protected goods and services in direct competition. Together they make *geographical exclusivity*, the quality, which has its separate importance when it is exercised in international trade, as it makes the patent (as well as other IPR) as private right equally effective in limiting cross-border movement of commodities and services as some administrative measures imposed by state. In other words the patent protection is liable to create cross-border barriers to free flow of goods and services. Moreover, splitting of rights through licencing of IPR between the right holders for different territories (i.e. countries), as a method of economical utilisation of said geographical exclusivity, is additional tool to control competition, though on the international scale.

However, this is exactly what the European integration<sup>13</sup> has been striving (and still strives) to eliminate. Throughout its genesis (from establishment of the Common Market in 60's and 70's which evolved into the Internal Market in 80s' and 90s' till now, when it emerges into the Single Market), the process was underpinned by the cross-border factor mobility and freedom to compete as its cornerstones and fundamental rights. Clearly, deployment of national IPR rules comes into conflict with the basic policies run by the European Community law.

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11 W. Cornish & D. Llewelyn, *op. cit.*, para. 1-30

12 *Ibid.*

13 This amorphous term tries, from historical point of view, to unite in one all stages of development of what we call today European Union. Also, the reader should be aware that the principles of free movement and the rules of competition applies equally to the relations within the European Economic Area (EEA) and thus everything that will be discussed under this paper.

The IPR, and hence the patent, operate mainly as a *form of legal exclusivity* towards the free enterprise market of each national state. Nevertheless, ever since the effects of their character have been tolerated by nations insofar that they have been in accordance with their actual public interest. Plainly, it is the permanent game of balancing between the two legitimate expectations, fair competition and free factor mobility, on the one hand and rights to protect intellectual property on the other. Here we deal with a unique supranational political and economical entity with its own analogous "free enterprise market" and with its new autonomous conceptions of "public interest". Thus, it is the same "ball game", but on a whole new level, and with some "new players" in. Therefore, alike national states the European Union (EU) have been forced to struggle in order to find the perfect balance between national intellectual property rules and its quintessential objectives-above all, establishment of the Common Market.<sup>14</sup>

Nonetheless, *the ultimate art in shaping of IP policy lies in securing outcomes that are proportionate to the aim of that protection.*<sup>15</sup> The purpose of this paper is to cast some light on how this was done within the European integration, in respect to patent rights.<sup>16</sup>

## SOURCES OF CONFLICT

Common markets presuppose custom unions enhanced with free factor mobility across national member frontiers, i.e. capital, labour, goods and services. The EU together with its predecessors is an example. Yet it is somewhat complex, as it was foreseen that it would become a complete economic union with a strong political flavour. This demands substantial unification of monetary and fiscal policies of national members. To that end the EU is, therefore, endowed with supranational central authorities that overlook the process.<sup>17</sup>

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14 Although, concepts such as "common market", "internal market" and "single market" represent different progressive stages of the European integration development, for the purposes of the work it will be used on equal terms. Also it will relate to the territory covered by EEA (EU + Iceland, Liechtenstein and Norway).

15 W. Cornish & D. Llewelyn, *op. cit.*, para. 1-01

16 Given the enormous scope of the Competition law of EU disproportionate to the ambit of the paper the author will concentrate on relation between national patent protection and EU free movement of goods policy and yet touch upon the competition rules when they refer to the main topic.

17 S. Weatherill, *op. cit.*, p. 169.

Accordingly, the magnitude of the integration, of which the core is the common market, implies that number of measures need to be adopted in order to unify or at least approximate national laws for it to function. "As far as intellectual property rights are concerned, it has been usual to work towards the unified law for the whole territory."<sup>18</sup> In the absence of such unification, the geographical exclusivity of national intellectual property laws and variations between the different legislative systems are capable of partitioning the internal market of the Community. Thus, there was a strong case for creating a *Community-wide right* as a mean "to eliminate differences of national law which may have a consequential effect on the free flow of goods within the internal market".<sup>19</sup>

However, reaching the common ground in relation to IPR, especially concerning industrial property rights, has always been a rather complex business, as national states tend to be protective of the interests of their own industries. Even though, they were part of economical integration that strived to establish internal market this remark was equally adequate in relation to Member States of European integration. Member States have been raising the question about the legal grounds for the legal intervention of the Community in this matter, often enough; there are no express authorities under the Treaty of Rome<sup>20</sup> or upon the constitutional arrangements which have amended it and added to the European Union.<sup>21</sup> The result was the lack of communitarian legislation upon which relevant institutions could turn, when resolving *the conflict between the free movement of goods and competition policy*, as milestones of the Common Market, on the one hand, *and national protection of IP* on the other.

In order to fill the legal gaps and handle the conflict, the European Court of Justice (the Court) and the Commission of the European Community (under its competences in administrating the Competition Law) were, therefore, left alone

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18 W. Cornish & D. Llewelyn, *op. cit.*, para. 1-50.

19 *Ibid.* para. 1-28.

20 The Treaty Establishing European Economic Community 1957, which has been amended several times (The Single European Act 1985, The Treaty on European Union 1992, The Amsterdam Treaty 1997, The Nice Treaty 2001).

21 The regulations on Community intellectual property rights and directives for the harmonization of national rights are being adopted pursuant non-specific provisions of Article 308 (regulations) and 95 (directives). Nevertheless, the states questioned, several times, before the European Court of Justice, the competence of the EC to adopt the measures in the field of IP, relying upon Article 295 that states the following: Treaty shall in no way prejudice the rules in Member States governing the system of property ownership. Although, the scope of this provision is not yet clear, nevertheless the Court refused to employ it [W. Cornish & D. Llewelyn, *op. cit.*, para. 1-28]

to derive the rules directly through "creative" interpretation of the Treaty of Rome (the Treaty) provisions.

The two crucial aspects of the Treaty are directly linked to this matter: one is elimination of restrictions upon free movement of goods between Member States, and second is establishment of a system to prevent distortions of competition in interstate trade. Articles 28-30 (free movement of goods) regulate the first feature, and it is the main concern of this paper, and the second is covered by Articles 81-86 (competition)<sup>22</sup> and will be touched upon where needed.

The Treaty itself, however, provides no simple answer:

#### Article 28

***Quantitative restrictions on imports and all measures having equivalent effect shall be prohibited between Member States.***

Accordingly, Article 28 strives to eliminate *quantitative restrictions* "as measures which amount to a total or partial restraint of, according to the circumstances, imports, exports or goods in transit"<sup>23</sup> and all *measures having equivalent effect*, "which amounts to all trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade."<sup>24</sup> Therefore, Article 28 is a quintessential instrument for the creation and maintenance of the Common Market in which free circulation of good is ensured. It precludes the isolation of national markets and thereby induces efficient and functional competition irrespective of the existence of national frontiers.<sup>25</sup> It seems that it pleads for national IPR to be deemed as unlawful barrier to the trade.

However, Article 30 and Article 295 may suggest otherwise.

#### Article 30

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<sup>22</sup> Both sets of provisions are directly enforceable, meaning, they constitute rights and corresponding obligations in individuals as well as in Member States, which may be enforced or pleaded in defence in litigation before national courts [W. Cornish & D. Llewelyn, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*, (London, Sweet & Maxwell, 2003) para. 1-50]. Basic distinction between the two, is that former deals with acts of States, and the latter with acts of private undertakings.

<sup>23</sup> *Geddo v Ente* [1973] 865, [quoted from: S. Weatherill, *op. c it.*, p. 241].

<sup>24</sup> *Procureur du Roi v Dassonville* [1974] ECR 837, *Ibid.* p. 245.

<sup>25</sup> *Ibid.*



The provisions of Articles 28 and 29<sup>26</sup> 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.

#### Article 295

***Treaty shall in no way prejudice the rules in Member States governing the system of property ownership.***

Article 30 introduces exemption from the principle prescribed by Article 28, by allowing for national territorial protections of intellectual property rights to be regarded as lawful barriers to the free trade, unless they "constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States." Furthermore, Article 295 supposedly reserves the "system of property ownership" for Member States.

The solution that would satisfy both legitimate expectations (free trade and unrestricted cross-border movement of goods, on the one hand, and the right to protect the intellectual property, on the other) is to be uncovered within the triangle of quoted provisions. Thereby, it is all left to proficiency of "judicial assessment of competing interests".<sup>27</sup> Following chapter will try to elucidate the Courts approach to the issue.

### THE APPROACH OF THE EUROPEAN COURT OF JUSTICE

Beneath, above described theoretical dissension between conflicting policies demands there is a real undergoing strife between the bearers of each, i.e. intellectual property right holders and parallel importers. While Article 28 embraces the interests of the latter, Article 30 endorses the rights of the former.

"Parallel importation" is a phenomenon in international trade which is the result of price differentials for the same goods between markets in different countries. In short, it is an undertaking of an independent entrepreneur to buy in a low-cost country in order to sell in a high-cost country, from obvious

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<sup>26</sup> Quantitative restrictions on exports, and all measures having equivalent effect, shall be prohibited by Member states.

<sup>27</sup> S. Weatherill, *op. cit.*, p. 241

reasons. The problem occurs when those goods are protected by IPR; the right holder naturally wants to prevent the middleman's activity to resale at a profit by invoking his exclusive rights and thus eliminate what he regards as unauthorized direct competition. Except preserving its "ability to discriminate in his pricing between different territories"<sup>28</sup>, the proprietor of IP has some further reasons for restraining parallel importing. In order to procure his products in new territories and explore and conquest new markets the right holder can introduce various strategies. For example, to achieve optimum in profit by cutting costs of introducing production and distribution of protected goods in country other than his home, the proprietor might prefer to assign his exclusive rights to a local licensee or distributor to do it instead. In return, for the sake of his investments, by acceding into position of right holder (for example, patentee, or trademark proprietor) in a given market the local licensee or distributor would like to be able to exclude the competition in his territory too. The same would desire some transnational corporation for its national subsidiaries through which it operates business in different countries, as each may be given exclusive rights in IP<sup>29</sup> (splitting of rights process). Therefore, inability of the right holder to exercise its exclusive rights to exclude competition in some territory, or to offer such exclusive rights to another, hampers his prospects to compete and yield upon its investments.

However, the EU has aspired to curb the excessive practices that discriminate one group of consumers from the other by triggering price differentials<sup>30</sup> in the Common Market. The parallel importation represents "an adjustment mechanism driving towards price uniformity"<sup>31</sup>; in addition it conduces to satisfaction of internal market and consumer's demands in protected goods. The Community, hence, considers the practice important to achievement of the internal market and supports the activity of parallel importers wherever possible.<sup>32</sup>

Accordingly, a difficult task was set before the Court to resolve, as it has been striving, ever since, to protect the purpose of the Common Market and yet not to hamper legitimate aims of national protection of IP. As the former cannot

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28 W. Cornish & D. Llewelyn, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*, (London, Sweet & Maxwell, 2003) para. 1-48.

29 *Ibid.* para. 1-48, 1-58, 18-02.

30 The phenomenon, however, is triggered by other factors too, such as fluctuation in currency exchange rates, government prices control in certain sectors (pharmaceuticals notably), the cost of establishment new products in particular parts of the market or variations in quality of products between different markets, etc. (*Ibid.* 18-02).

31 *Ibid.* 18-02.

32 *Ibid.*

entirely override the latter, and *vice versa*, the real knob left before the Court to disentangle is to which extent the territorial exclusivity of IPR is proportionate to its objectives and therefore acceptable against fundamental communitarian goals.

The Court's solution, in attempt to conciliate the antagonistic demands, is based upon a distinction between the *existence* of national IPR and their *exercise*. Hence, "it cannot question their existence, but it will control their exercise"<sup>33</sup>. Thereby, the Court implies that whilst the national intellectual property right itself cannot be deemed as to be contrary to the Treaty, yet their application has to be confined for to be in accordance with it.<sup>34</sup> In other words, by this method Luxembourg avoids possibly unpleasant outcomes of Article 295.

The Court curbs the *exercise* of IPR through the conception of the *specific subject matter*. Accordingly, the right holder can invoke his intellectual property rights, to restrain the cross-boarder movement of protected goods, until they are exercised within their substance, i.e. within the specific subject matter, contents of which is upon the Court to assert. Therefore, only within that scope, free trade can be restricted through the exercise of IPR by its proprietor and anything beyond that would be seen as an excessive use of the right.

In defining the specific subject matter for each class of IPR the European Court of Justice leans upon a universal *exhaustion of right doctrine* that it derives from national legal systems and adjusts to communitarian legal order.

As a general concept, *exhaustion of rights rule provides that IPR cannot be deployed to control the subsequent marketeering of protected commodities after first sale is committed by the right-owner or with his consent*. As far as the patent law is concerned, this institute is explicitly formulated in laws of a rather small number of countries<sup>35</sup>. Yet, as the institute it exists literally from the genesis of this branch of intellectual property law. "Actually it is a result of teleological interpretations of patent law provisions, thus it is a product of legal doctrine and case law."<sup>36</sup> It serves as a criterion for resolving collisions between two different legal authorities over certain protected good that together arise from

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33 S. Weatherill, *op. cit.*, p. 547

34 The method of interpretation based upon dichotomy between existence and exercise of intellectual property law is similar to one practiced within the international private law. Namely, when asserting applicability of applicable foreign law provision in domestic legal system against *lex fori* public order, the local court is supposed to appreciate whether its legal effects are in accord or in discord with the local order public, not its content.

35 Belgium, France, Spain [S. M. Marković, *Patentno pravo* (Beograd, Nomos, 1997) p. 300].

36 *Ibid.*

intellectual property on the one hand and property ownership on the other.<sup>37</sup> According to above definition the purpose of the institute is to prevent an excessive use of IPR as a mean to restrain trade and competition. "But often, this is confined to first sales within the territory covered by the right - it amounts to a principle of domestic, rather than international, exhaustion. Accordingly, national rights that are subject to such limitation can still be used to prevent the importation of goods sold abroad by the national right-owner or goods which come from an associated enterprise."<sup>38</sup> Confining the effects of the institute to domestic territory leads to the discrimination of entrepreneurs from elsewhere in the internal market. There the IPR policy comes into the conflict with another fundamental communitarian principle, *non-discrimination*.<sup>39</sup> Another problem is that the scope of the rule varies, from country to country and from subject-matter to subject-matter and in some cases the reverse approach might occur.<sup>40</sup>

Therefore, the European Court of Justice, extracted, somewhat, general idea that is most common to national conceptions, and morphed it into the *community-wide exhaustion of right* concept suitable for the internal market. The solution is more or less blind for internal national boundaries within the Common Market; alike the Court itself strives to be whenever the proper internal market functioning is challenged. Furthermore, once it grew into the communitarian rule, the national exhaustion rules became irrelevant.<sup>41</sup> In

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37 *Ibid.*

38 W. Cornish & D. Llewelyn, *op. cit.*, para. 1-49

39 Within the scope of application of this Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality shall be prohibited (Article 12, the Treaty Establishing the European Community). See also Article 30 above.

40 The British traditionally adopted a principle of non-exhaustion in the case of patent law, which means that any subsequent uses and sales require the patentee's licence. This approach is in discord with one generally accepted in the field and with solution adopted by the Court.

41 Generally it is known the legislation or other written sources of law are not always able to give answers to every question that comes before the courts. On the other hand if the courts are competent to resolve such legal questions, they cannot refuse the legal protection on the basis that the issue is not regulated by existing legislation. If this is the case, the courts are entitled to recourse to general principles of law in order to decide it. *Regula pro lege, si deficit lex*. Accordingly, the European Court has developed a doctrine that rules of Community law may be derived, not only from treaties and legislation, but also from the general principles of law [T.C. Hartley, *The Foundations of European Community Law*, (New York, Oxford, 1998), p. 130].

The functional source of the principles arises either from the Community Treaties or from the legal systems of the Member States. However, whatever the factual origin of the principle, it is applied by the European Court as a principle of Community law, not national law (*ibid.* p. 131).

The general source that gives rise to the approach of the Court is Article 220{164} of the Treaty which states: "The Court of Justice shall ensure that in the interpretation and application of this

summary, in the same way that the national courts protect integrity of national markets, the European Court of Justice protects integrity of the communitarian market.

The principle works in several ways; legally, by its "lacuna-filling role" within the Community law it substitutes and overrides the national rules of exhaustion with the single communitarian. Technically, it overcomes the time gap while awaiting for the Community legislation to be passed in the field that will set the common rules for all the "players". In fact it creates boundaries to the area where national rules of IPR can be freely exercised to the detriment of the free flow of goods policy within the EU with the European Economic Area adhered.

Although, the method briefly explained above, could be contested as "too creative" as it allegedly trespasses into the legislative competences, it is the very same pattern of teleological interpretation which led to determining of the *principle of the precedence of Community law*<sup>42</sup>, that is *supremacy*.<sup>43</sup> Thereby, the solution is not driven by legal scrutiny but rather by the "or else" argument, i.e. by the fear that alternative solution would lead to the eventual erosion of the Common Market.

However, through analyses of communitarian case law, the following chapter will try to evaluate on how the approach of the Court reflects upon the patent law.

## CASE LAW

Like it was already stressed above, the geographical exclusivity of patent rights enables the patentee to exercise its legal monopoly so to deny access to the national market to protected goods of any competitor from elsewhere if their undertaking can be regarded as unauthorized. As a result, the patentee from

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Treaty the law is observed". It is widely accepted that the word "law" must be understood as to refer to something over and above the Treaty itself (*ibid.* p. 131). As a result, it arises that the Court is ordered to apply the general principles of law when it is appropriate. It should not, however, be thought that the Court always makes express reference to general principles whenever it propounds new rules of law. Sometimes it simply states a rule without any express indication of its source; it may give a justification based on policy or the general requirements of the Community legal system. However, if the formal source for such rules were required, it could always be found either on the basis of a wide interpretation of a written text or on the basis of the general principles (*ibid.* p. 132).

<sup>42</sup> Amministrazione delle Finanze v Simmenthal [1978] ECR 629 [S. Weatherill, *op. cit.*, p. 84.]

<sup>43</sup> Doctrine introduced in Costa v ENEL [1964] ECR 585.

country Impo (the patent holder's country) can block exportations of patented goods from country Expo and their subsequent marketeering in the country Impo, relying upon its exclusive right to manufacture and sell such goods. The right-holder is entitled to do so even if the importer has a patent granted for the identical invention in the country Expo or, moreover, notwithstanding the fact that a parallel importer might have acquired the goods that eventually originate from the patentee or from its associates.<sup>44</sup> The geographical exclusivity, thereby, runs contrary to the Community objective of economic integration.

In order to defuse a clear rift between Article 28 and Articles 30 and 295 the Court established the specific subject matter doctrine. The best way to grasp it is to study the "textbook" cases through which it was shaped. Each case analyzed below will consider particular issue regarding the patent law.

*Centrafarm BV v. Sterling Drug Inc.* [1974] E.C.R. 1147, (parallel patents)

In the *Sterling Drug* case, the Court used the opportunity "to patent" its *existence-exercise* method, described above, in order to delimit the scope of the national patent protection.

"Sterling Drug held parallel patents in several Member States for certain pharmaceuticals, including the drug NEGRAM. The products protected by those patents were lawfully marketed in those Member States either by Sterling Drug or by undertakings to which Sterling Drug had granted licences. Centrafarm, a third party, bought up stocks of NEGRAM in the UK and exported them to the Netherlands. There, they were able to make a substantial profit, because the cost of NEGRAM on the Dutch market was far higher than its cost in UK. Sterling Drug initiated patent infringement proceedings to prevent NEGRAM being marketed in the Netherlands by Centrafarm. Centrafarm argued that they had a right under Community law to export the drug from one Member State to another, given that Sterling Drug had consented to the marketing of the product in both States. The Dutch court referred questions about the relevance of Community law to Luxembourg (the European Court of Justice seat - author's remark)".<sup>45</sup>

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<sup>44</sup> This is a most usual case when a national legal system restricts the application of the principle to rather domestic than international exhaustion.

<sup>45</sup> *S. Weatherill, op. cit.*, p. 548.

Bearing in mind that it was dealing with *property*, the European Court of Justice avoided taking stand explicitly upon *an arbitrary discrimination or a disguised restriction on trade* exemptions posited by Article 30 fearing that it might have been trespassing into the special preserve prescribed by Article 295.<sup>46</sup> Instead, it relied upon dichotomy between existence and exercise of industrial and commercial property rights by stating that *it is clear from [Article 30], in particular its second sentence, as well as from the context, that whilst the Treaty does not affect the existence of right recognised by the legislation of a Member State in matters of industrial and commercial property, yet the exercise of these rights may nevertheless, depending on the circumstances, be affected by the prohibitions of the Treaty*<sup>47</sup>.

Therefore, the Court held that derogations from free movement policy rendering from Article 30 can be made only *where such derogations are justified for the purpose of safeguarding rights which constitute the specific subject-matter of this property*,<sup>48</sup> and then it defined the *specific subject matter of patent rights* as:

*the guarantee that the patentee, to reward the creative effort of the inventor, has the exclusive right to use an invention with a view to manufacturing industrial products and putting them into circulation for the first time, either directly or by the grant of licences to third parties as well as the right to oppose infringements.*<sup>49</sup>

Accordingly, the definition of specific subject matter delimits the area within which the free trade can be restricted through the exercise of the national patent rights. Therefore, its real contents concern the scope of exhaustion. Furthermore, the Court additionally specified the range of its application in relation to the free movement of goods policy:

Whereas an obstacle to the free movement of goods of this kind may be justified on the ground of protection of industrial property where such protection is invoked against a product coming from a Member State where it is not patentable and has been manufactured by third parties without the consent of the patentee and in cases where there exist patents the original proprietors of which are *legally and economically independent* (bolded by author), a derogation from the principle of the free movement of goods is not, however, justified where the product has been put onto the market in a legal manner, by

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46 W. Cornish & D. Llewelyn, *op. cit.*, para. 18-05. Note, also that as the British law accepted the domestic principle of non-exhaustion in the field of patent rights, the parallel importer from elsewhere in the Community was legally in the same position as a domestic distributor and therefore not discriminated against.

47 Sterling Drug *ibid.* p. 549

48 Centrafarm BV v. Sterling Drug Inc. [quoted from W. Cornish & D. Llewelyn, *op. cit.*, p. 18-05]

49 Centrafarm BV v. Sterling Drug Inc. [Quoted from S. Weatherill, *op. cit.*, p. 548]

the patentee himself or with his consent, in the Member State from which it has been imported, in particular in the case of a proprietor of parallel patents.<sup>50</sup>

In other words, the industrial property rights and thus the national patent protection are efficient against direct competition of manufacturers and their distributors that are independent (*legally and economically*) from the right holder. On the other hand, it cannot be invoked against parallel importers whom acquired the patented goods that had, previously, been put by patentee *into circulation for the first time, either directly or by the grant of licences to third parties*. For them the patent rights are considered to be exhausted. Moreover, the wording of the Court's decision suggests that the patent right is equally exhausted to patentee when patented products are first marketed by a person *connected with the patent holder through a corporate grouping, manufacturing licence, distribution agreement, etc.*<sup>51</sup>

In the end, the Court underscored that *the exercise, by the patentee, of the right which he enjoys under the legislation of a Member State to prohibit the sale, in the State, of a product protected by the patent which has been marketed in another Member State by the patentee or with his consent is incompatible with the rules of the EEC Treaty concerning the free movement of goods within the Common Market, owing to the fact that otherwise he would be able to partition off national markets and thereby restrict trade between Member States, in a situation where no such restriction was necessary to guarantee the essence of the exclusive rights flowing from the parallel patents.*<sup>52</sup>

Given the circumstances, the decision implies that the exercise of the patent right, stemming from national legislation to restrain the sale, can be considered as a *measure having equivalent effect*<sup>53</sup> to the *quantitative restrictions* prohibited by Article 28. Although, Article 28 is aimed at the Member State's intervention, the Court holds that a patent infringement action before a national court by patentee, founded upon a national patent law, can be considered as an emanation of the State through the private initiative. To be more specific, it may be deemed as an application of a trading rule enacted by a Member State capable of hindering intra-Community trade *indirectly*. Thereby it could be caught by the said provision. Accordingly, "the application of the Article 28 prohibition is dependent on the *effects* of the measure" and hence "bites where a national rule is shown to have an effect prejudicial to the integration of the

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50 Centrafarm BV v. Sterling Drug Inc. *ibid.* p. 549

51 Note, that in the Sterling Drug case, the NEGRAM drugs were being marketed either by Sterling Drug or through its subsidiaries.

52 Centrafarm BV v. Sterling Drug Inc. *ibid.* p. 549

53 Defined by the Court as all trading rules enacted by Member States which are capable of hindering, directly or indirectly, actually or potentially, intra-Community trade {Procureur du Roi v. Dassonville (case 8/74) [1974] E.C.R 837, quoted from S. Weatherill, *op. cit.*, p. 245}.



markets of the Member States."<sup>54</sup> Therefore, under certain conditions, invoking the national patent right before the national court so to prohibit cross-border movement of patented goods, is deemed as manifestation of the restrictive effect of national trade rule on inter-State trade.

The fact that Sterling Drug had consented marketing of the protected products by a member of the group (subsidiary) in the Member State qualified the exercise of the patent rights through infringement action as a measure having equivalent effect. In other words consent to the undertaking in the UK exhausted its patent rights in the Netherlands. As a result Centrafarm was availed under Community law to freely export and sell the NEGRAM on the Dutch market and profit from the higher prices there. The emphasis are on "*consented marketing*", thus any further attempt of a patentee to control subsequent marketing in the Common Market is beyond the specific subject matter, hence prohibited by Article 28 as a measure having equivalent effect.

However, while shaping up the Community-wide principle of exhaustion the Court did not deduce any explicit justification grounded upon a comparative study in order to find the common denominator between the different legal systems. If it had tried to do so then it would have noticed that the Benelux legal system accepts "at least some degree of international exhaustion"<sup>55</sup>, and, by contrast, the British patent system embraces principle of non-exhaustion.<sup>56</sup> Hence, the fact is that the position in Member States is not uniform; in addition it differs from one type of IP to another.<sup>57</sup> Thereby, if the Court was to endorse each solution that derives from any applicable national law to a case, the position of interested players, under same circumstances but in different parts of the internal market would vary.<sup>58</sup> That would make it hard for entrepreneurs to plan their business conducts within the Common Market due to unpredictability of the applicable law. Equally, it would impede the economic interpenetration and undermine free trade within the internal market.

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<sup>54</sup> *Ibid.* p. 244.

<sup>55</sup> W. Cornish & D. Llewelyn, *op. cit.*, para. 17-119 (footnote no. 79).

<sup>56</sup> *Ibid.* para. 1-49, 6-16.

<sup>57</sup> *Ibid.* para. 18-05.

<sup>58</sup> Hypothetically speaking, if the parallel importing took place in UK from the Netherlands, given that applicable British patent law generally accepts principle of non-exhaustion, the local court would uphold Sterling Drug's position. Vice versa, if the parallel importing took place in Holland from the UK, the local court would uphold the stand of Centrafarm due to the principle of international exhaustion embraced by applicable Dutch law. In the end, if the undertaking took place in some other country, that combines principle of exhaustion limited in scope for national territory and principle of non-exhaustion for importation coming from elsewhere, the local court would sustain Sterling Drug's stance.

Therefore, in order to eliminate legal uncertainty as a result of the variations between the different legislative systems on the subject, the Court in *Sterling Drug* adopted a pragmatic approach by setting a unified communitarian rule:

The national patent rights are inexorably exhausted towards patented goods once they are marketed for the first time by the right holder or with his consent within the Common Market.

*Sterling Drug*, without indecision, favours activities of parallel importers and free trade and reins patent holders and national patent protection in return. In the succeeding case, The European Court of Justice reiterated its stance, ignoring different circumstances.

Merck v. Stephar [1981] E.C.R. 2063, (unprotected and protected market)

Here, it was the case of the patent holder operating in an unprotected and protected market. Namely, Merck marketed certain drug in Italy that was not protected by a patent there, but did have the patent for it in the Netherlands. Moreover, pharmaceuticals were not even patentable under the Italian legal system at the time. Anyhow, the parallel importer (Stephar) acquired the drugs in Italy and exported to the Netherlands. Even though, Merck had not been able to profit from patent protection in Italy, "the fact that it had itself undertaken the marketing there was treated as exhausting the Dutch patent right".<sup>59</sup>

The approach was often doubted by commentators as it raised the question whether would right holders, refrain from crossing the border eager to protect their home markets; first in order to avoid communitarian exhaustion of their national patent rights<sup>60</sup>; secondly, to avoid depriving themselves of the benefit of the enhanced value of the product within home markets<sup>61</sup>. If that would be the case, that may deprive consumers from elsewhere in the Common Market of a new and desirable product, and moreover it could undermine the economical justification of the Court's approach, which is to eliminate undesirable price differentials for the same product between Member States.<sup>62</sup>

From the legal point of view, the first concern appears superfluous, as it can be deemed that once patented goods have been put on the market in any part of

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59 W. Cornish & D. Llewelyn, *op. cit.*, para. 18-04.

60 S. Weatherill, *op. cit.*, p. 549.

61 W. Cornish & D. Llewelyn, *op. cit.*, para. 18-07.

62 *Ibid.* para. 18-02.

the Community including the home market, by the patentee or with his consent, the national patent right will be considered exhausted to them. Although, so far there is no established case law to support such view<sup>63</sup>, nevertheless it is a solution that is accepted within the Community Patent Convention 1975<sup>64</sup> (CPC) (see the following case), which has not been put into effect yet, but it is utterly based upon the Court's positions.<sup>65</sup> Moreover, the solution would be logical outcome of the Court's treatment of the Common Market as "an area without internal frontiers"<sup>66</sup>. In addition, it should be noted, that *Sterling Drug* implies the same, as from the parallel patent holder's viewpoint, each Member State in which he obtained the patent right is "the home court" for him and yet consensual marketing in one triggers the exhaustion of his rights in another.

Still, from the economical point of view, the *Merck* decision could make it hard for the patentee to market in cheaper markets, since to do so threatens to reduce the home markets price of patented products due to parallel importers' activities.

Nonetheless, the Court adhered to *Merck* by refusing to alert its position in the succeeding case, in spite of being encouraged by its Advocate General, Mr. Fenelly to reconsider it.<sup>67</sup> Hence, the reason that the right holder had no equivalent right available in Country Expo from which to extract a benefit had no any relevance to the application of the communitarian principle. What mattered to the Court was the fact that the patent holder had conducted "the consented marketing" in one Member State, and thus triggered the exhaustion of its patent rights in another.

Hence, "national patent infringement proceedings brought against reimports will be defeated by reliance on Article 28, as *Sterling Drug* and *Merck* discovered".<sup>68</sup>

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63 Presumably because the patent infringement procedures occur where economic interests of patent holders are endangered, that is when the parallel importation of patented goods from cheaper markets deters their market powers on domestic market.

64 The Convention for the European Patent for the Common Market (Official Journal 1976, L 17, p.1).

65 W. Cornish & D. Llewelyn, *op. cit.*, para. 6-16. Note, that the same approach was accepted by Community Trade Mark Regulation 40/94/EC.

66 The Treaty Establishing The European Community, Article 14 (2).

67 *Merck and others v. Primecrown Ltd* [1996] E.C.R I-6285.

68 S. Weatherill, *Cases and Materials on EC Law* (London, Blackstone Press Limited, 2001) p. 550.

What is not entirely clear is the precise meaning of the consensual marketing conception. What does that purport? What is its scope? The following case refers to this.

***Pharmon BV v. Hoechst AG [1985] E.C.R. 2281 (compulsory licence)***

Hoechst, a German company held patents on the drug, "Frusemide", in several Member States, including Holland and the United Kingdom. Despite holding the patent, Hoechst had never manufactured it in the UK, nor it consented the manufacture or marketing to others. Nevertheless, the drug had been manufactured in the UK, by DDSA as a result of the grant of a compulsory licence under UK legislation to manufacture and sell "Frusemide" in the UK, albeit under condition that a royalty is paid to the right holder and subject to a prohibition against export. When batches of "Frusemide" produced by DDSA in the UK reached the Dutch market, where Pharmon, a local company, wished to sell them, Hoechst sought to rely upon its Dutch patent to exclude the goods. Pharmon, on the other hand, claimed the right under Art. 28 to sell the British drug in Holland by holding that it could be asserted, in a view of *consensual registration* of the patent in the UK by Hoechst, ***that the nature of a compulsory licence is no appreciably different from that of a licence freely granted***<sup>69</sup>. Thereby it may be deemed that the decision of the national authorities replaced the consent of the patent proprietor and thus, ***in any event, the exhaustion of patent rights is also applicable where the product has been marketed in the Member State where the compulsory licence was granted.***<sup>70</sup>

However, the European Court of Justice avoided upholding such, rather, bold reasoning.<sup>71</sup> It stood up to the exhaustion of right principle as it set in previous cases and inferred that it cannot be deemed that patentee impliedly consented to the operation of the third party to whom the competent authorities of a Member State granted the compulsory licence, simply because of his consensual patent registration in the Member State. The Court corroborated its stand by maintaining that ***such a measure*** (bolded by author) ***deprives the patent proprietor of his right to determine freely the conditions under which he markets his***

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<sup>69</sup> Ibid. [quoted from S. Weatherill, *op.cit.*, p. 550]

<sup>70</sup> Ibid.

<sup>71</sup> However, it should be stressed that exhaustion of right under national law could arrive when the patented goods are put into circulation by a third party, without consent of the right holder, save that the undertaking is not illegal. This could be the case of either the right of the prior user, or due to compulsory licence [S.M. Markovic, *Patentno pravo*, (Beograd, Nomos, 1997) p. 302].

*products.*<sup>72</sup> Then, it reiterated the definition of the subject-matter of the patent right and deduced that it is *necessary to allow the patent proprietor to prevent the importation and marketing of products manufactured under a compulsory licence in order to protect the substance of his exclusive right under his patent.*<sup>73</sup>

Furthermore, the Court decided to ignore the conditions to which the authorities subjected the grant of compulsory patent, by holding that in a view of the application of Community law to the national legislation in question is irrelevant *whether a prohibition on exportation is attached to the compulsory licence, whether that licence fixes royalties payable to the patentee or whether the patentee has accepted or refused such royalties.*<sup>74</sup>

Clearly, the Court refuses to confuse the *consensual registration* of the patent right with the *consensual marketing*, and, therefore, to hold it as fact that triggers exhaustion of the patent right. Hence, "the Court view of *consent* in this case is narrow it favours the right holder; it weakens free trade. Hoechst had not given such consent, which distinguished its conduct from that of Sterling Drug."<sup>75</sup> Furthermore, had the Court in *Merck* decided otherwise, not only would it have substituted a free and voluntary exercise of an industrial property right with a public measure ridden by a public interest and coercion, together that would have been a factual extension of a legal effect of a measure adopted by a public authority of one country over legal order in another via application of Community law, which would have been reasonably unacceptable.

This view is in accordance with the provisions of CPC too, which *has not yet come into force, nevertheless expresses the position of the Member states in that respect.*<sup>76</sup> CPC insists for patent rights to be exhausted, patented goods must have been, previously, "put on the market *in any part of the EC* by the patentee or with his *express consent* (bolded by author)."<sup>77</sup> Furthermore, it holds that "if the ownership of national patents for the same invention has been divided up among patentees *economically associated* (bolded by author), so that a different legal person must license the initial sale in the different countries, the rights will still be treated as exhausted."<sup>78</sup> That brings us back to *Sterling Drug*, where the Court insisted that in order to be successful, patent infringement

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<sup>72</sup> *Ibid.* p. 552

<sup>73</sup> *Ibid.*

<sup>74</sup> *Ibid.*

<sup>75</sup> S. Weatherill, *op. cit.*, 2001) p. 552

<sup>76</sup> Pharmon, *Ibid.* p. 551

<sup>77</sup> W. Cornish & D. Llewelyn, *op. cit.*, para. 6-16.

<sup>78</sup> *Ibid.*

proceedings must be triggered against importers whom acquired a *product coming from a Member State where it is not patentable and has been manufactured by third parties without the consent of the patentee and in cases where there exist patents the original proprietors of which are legally and economically independent*.<sup>79</sup> Otherwise, communitarian doctrine of exhaustion "takes effect not only upon release of relevant goods in one Member State by the right-owner itself, by equally where there is any legal or economic connection between the first marketer and the right-holder."<sup>80</sup>

Thus, what we can generate from cases cited above is the following:

***The national patent rights are inexorably exhausted towards patented goods once they are marketed for the first time by the right holder or with his consent within the Common Market.***

***The consent of the right holder has to be express. The fact of economical association between the patentees works as a sort of legal presumption to the express consent.***

However, another fact, which distinguishes *Pharmon* from *Sterling Drug* and *Merck*, is that here the Court was dealing with *direct exports*, and yet it considered the case as a parallel importation.<sup>81</sup> This raises an important question. Had Hoechst voluntarily granted the licence to manufacture and marketing "Frusemide" to DDSA, would it have been entitled to prohibit its direct exports relying upon the national patent right?

***Nungesser v. EC Comission [1982] E.C.R. 2015 (exclusive licence, licensor- licensee relation)***

The *Pharmon* decision could suggest that as the compulsory licence granted in Country Expo did not avail DDSA and its distributor of freedom to undertake the export of protected product into Country Impo than, *argumentum a contrario*, the consented patent licence granted by Hoechst would do so. But what if Hoechst, as a licensor, had reserved the exclusivity in Dutch market to itself and prohibited to DDSA, as a licensee, to manufacture and sell over there.

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<sup>79</sup> *Centrafarm BV v Sterling Drug Inc.* [Quoted from S. Weatherill, *Cases and Materials on EC Law* (London, Blackstone Press Limited, 2001) p. 548]

<sup>80</sup> Cornish & D. Llewelyn, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*, (London, Sweet & Maxwell, 2003.) para. 1-58.

<sup>81</sup> *Pharmon* was the local distributor, not the parallel importer, i.e. it did not acquire the patented goods in the UK so to sell it in the Netherlands. DDSA exported the goods directly onto Dutch market [W. Cornish & D. Llewelyn, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*, (London, Sweet & Maxwell, 2003.) para. 18-07]

Could then DDSA rely upon Article 28 to override such a prohibition?<sup>82</sup> In other words, *are the exclusive licences to reserve territories liable to restrict trade within the Common Market, and if they are to which extent?*

Plainly, there is no simple answer to this respect, as it crosses over the area "all reserved" for fundamental freedom of contract. Since Article 28 deals with acts of Member States, it is not entitled to regulate private arrangements between contracting parties. Thereby, in above-mentioned circumstances, DDSA would have not been able to invoke Article 28 against Hoechst.<sup>83</sup> Still, that does not clear out the case for preserving exclusivity. Such deliberations of private entities to fortify the area of their interests are potent to create divisions within the Common Market and restrict competition. Therefore, they are regulated by Competition law, i.e. by Articles 81 and 82 (85 and 86, pre-Amsterdam) of the Treaty.

"In its decisions of the 1970s on patent licences, the Commission's starting point was that undertakings to ensure the exclusivity of territories were restrictive of competition in the sense of Art. 81(1) of the Treaty of Rome, since they necessarily involved a surrender of freedom."<sup>84</sup> Furthermore, the Commission "considered that the ultimate objective of unifying the internal market justified treating a licence to manufacture in one country of the Community as a licence to sell in all."<sup>85</sup>

However, in the *Maize Seed* decision<sup>86</sup>, the European Court of Justice, as a power entitled to supervise the Commission's administration of these rules, constituted the *via media* solution. The Court differentiated exclusive licences that are solely aimed to regulate the contractual relationship between the licensor and licensee, *whereby the owner* (licensor - remark of author) *merely undertakes not to grant other licences in respect of the same territory and not to*

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82 And otherwise, had the DDSA, as a licensee preserved exclusivity of UK market via exclusive licence towards Hoechst would have Hoechst been able to export directly leaned upon Article 28?

83 In reality, DDSA would not even have the interest to do so as a contracting party. This is due to a fact that as a licensor and a licensee, the companies would have a natural urge to avoid the direct competition of each other on the given market. Hence they would rather strive to divide their areas of interest.

84 . Cornish & D. Llewelyn, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*, (London, Sweet & Maxwell, 2003.) para. 7-34.

85 *Ibid.*

86 *Nungesser v EC Commission* [1982] E.C.R. 2015. The holder of a parallel patent in Germany for a new plant variety in a new form of maize seed, a French research organization INRA, had granted an exclusive manufacturing and sales licence for that country, to Nungesser, a German company. The Commission held that the exclusive licence is void against Article 81 by its very nature, thus Nungesser appealed to the Court in order to annul the decision.

*compete himself with the licensee on that territory*<sup>87</sup> (open exclusivity), from exclusive licences that purport the absolute territorial protection *under which the parties to the contract propose,.....,[strive] to eliminate all competition from third parties, such as parallel importers or licensees for other territories*<sup>88</sup> and therefore tend to extend the effects of an agreement to third parties whom are not bound to it.

Luxembourg concluded the following:

*Having regard to the specific nature of products in question,.....,the grant of an open exclusive licence, that is to say a licence which does not affect the position of third parties such as parallel importers and licensees for other territories, is not in itself incompatible with Article 85(1) (Article 81(1) post-Amsterdam - author's remark) of the Treaty.*<sup>89</sup>

On the other hand, *the Court has consistently held,....., that absolute territorial protection granted to a licensee in order to enable parallel imports to be controlled and prevented, results in the artificial maintenance of separate national markets, contrary to the Treaty.*<sup>90</sup>

It follows, that the permissibility of open exclusive licences against Article 81(1), is to be assessed upon prevailing circumstances of certain market. Thereby regarding *the specific nature of products in question*, the exclusive licence is liable to be exempted from prohibition save it *does not affect the position of third parties*. On the other hand, if the arrangement imposes absolute territorial protection, so to inhibit parallel importation, it will be bad under Competition law without excuse, as it creates "artificial" divisions in the single European market.

It was recognized long ago that the technology contained within some invention has a distinct market value from that of a protected product alone. The patent powers the invention so to become a kind of an intangible good. The exclusive licences are the legal means for such "good" to be marketed. As a consequence by virtues of patent law the competition is enhanced from the level of commodities to the level of technologies.<sup>91</sup> The accent is, therefore, on competition between technologies so is the ratio of this decision.

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<sup>87</sup> *Ibid.* [Quoted from S. Weatherill, Cases and Materials on EC Law (London, Blackstone Press Limited, 2001) p. 426].

<sup>88</sup> *Ibid.*

<sup>89</sup> *Ibid.* p. 427

<sup>90</sup> *Ibid.*

<sup>91</sup> S. M. Marković, *Patentno pravo* (Belgrade, Nomos, 1997) p. 36, 37.



Here, the Court was dealing with the licensor's legitimate interest of *introducing new technology* in another market through exclusive licensing. In return, it was confronted by the licensee's legitimate fear of possible direct competition from the licensor and other licensees in the market. In addition, consumers, namely the farmers, had their share of interest that needed to be protected, which was to come into possession of new technical knowledge. Hence, the arrangement that was seemingly restrictive of competition in this case had some *countervailing effects*. By enabling penetration into the market of another Member State to the licensor and reserving territorial exclusivity for the licensee, the exclusive licence provided dissemination of a new technology. Moreover, instead of restraining, in a way the exclusive licence induced the competition between technologies, the new one and existing ones. The Court did not fail to recognize it; therefore, instead of entirely suppressing such initiatives of entrepreneurs, it decided to uphold them as *desirable deals*. It held the practice legitimate, especially if it was the only mean of promoting the competition and technology transfer and allowed consumers, in return, a fair share of the resulting benefits. Had the Court decided otherwise, "the competition would be prejudiced by the licensor's inability to offer exclusive rights" subject to the licensee's apprehension from the direct competition of other licensees.<sup>92</sup> Consequently, the German farmers deprived of easy and cheap access to the new technology, would be discriminated against the French. Therefore, if the agreement itself is not ridden to distort competition, some *reasonable restraints* shall be appreciated insofar that they are confined to minister some desirable aims. The restraints shall be thus tolerated only if they are indispensable for attainment of such aims; "unduly tight and lengthy restrictions will not escape the prohibition in this way".<sup>93</sup> The Court hence will not countenance licence that seeks absolute territorial protection i.e. that suppresses parallel trade. Transmitted into another line of observation, it follows that, whereas exclusive licences are tolerated when they assure the competition at the level of technologies, they are persecuted when they restrict competition at the wholesale level.

However, the Maize Seed decision needs to be observed from another aspect. Even though, contracts in general are not capable to bound and impose burdens upon third parties, due to the *inter partes* principle, there are still some types of contracts that are exceptions. It is thoroughly accepted that the exclusive licence of patent rights is one of the kind; it is an act that transfers exclusive rights, where a licensee accedes into the position previously held by a

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92 W. Cornish & D. Llewelyn, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*, (London, Sweet & Maxwell, 2003.) para. 7-34.

93 S. Weatherill, *Cases and Materials on EC Law* (London, Blackstone Press Limited, 2001) p. 427.

licensor in respect of the exclusive rights to commercially use invention within the specified territory. Thereby, the licensee is supplied with both positive and negative authorities; they operate *erga omnes*, i.e. affect the position of third parties, including the licensor.<sup>94</sup> The authorities arise from the exclusive nature of right conveyed by the arrangement. The elaboration of the *Maize Seed* decision is, apparently, in discord with generally accepted legal nature of the exclusive licence contracts.

Yet, it is the general principle of the law that the assignor (licensor) cannot transfer more authorities on assignee (licensee) than it actually possesses; the effect of the exclusive licence to the third parties position is proportionate to the substance of the right transferred by it. From this principle arises that contracting parties cannot exceed the substance of the patent right by contracting will. *Sterling Drug* curbs its substance by the specific subject matter conception, which limits effects of the patent right solely to restrict the unauthorized direct exportation, whilst keeping them inefficient against parallel importers. Thereof the licensor is in no position to endow licensee with such capacity. Therefore, notwithstanding the inconsequent wording, the mentioned effects of the *Maize Seed* decision are in accord with the substance of the patent right defined in *Sterling Drug*. In other words, *Maize Seed* preserves the *erga omnes* effect of the exclusive licence within the specific subject matter of patent rights delimited by *Sterling Drug*. The two decisions complement each other.

However, the *Maize Seed* decision is not entirely clear about exclusivity between different territorial licensees. From cited above it appears that *Maize Seed* verges on more to the stance that exclusive licences are not liable to affect "licensees for other territories". Nevertheless, Article 1 of a Block Exemption<sup>95</sup> for Technology Transfer<sup>96</sup>, a regulation formulated by the Commission in 1996 and mainly based upon *Maize Seed* conception, exempts the licensee's undertaking not to manufacture or to engage actively in selling in the territory of another licensee.<sup>97</sup> The same, more or less, arises from the latest Regulation, adopted in 2004, which substituted formerly mentioned.<sup>98</sup> The regulations, therefore,

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94 S. M. Marković, *op. cit.*, p. 318, 319.

95 Block Exemption specifies conditions under which a licence need not be individually justified before the Commission if it pursues the provision.

96 Reg. (EC) 1996/240, O.J. L31/1996.

97 W. Cornish & D. Llewelyn, *op. cit.*, para. 7-35.

98 Reg. (EC) 2004/772, O.J. L123/2004. Fundamental difference in relation to the Regulation in 1996 is that in order to simplify the regulatory framework the new Regulation moved away from the approach of listing exempted clauses; instead it prescribes the general exemption of "technology transfer agreements", while explicitly outlining the list of so called hardcore

recognize the positive effects of the exclusive licence towards the licensees for other territories. Nonetheless, they do not regulate analogous undertaking of the licensor; that is to say, undertaking of the licensor to prevent the licensees for other territories to engage directly in the licensee's exclusive territory.

In our opinion, the licensee does not need such guarantee from the licensor, anyway, as it is a power already contained within the exclusive licence; that is an authority, which is constituted by the agreement in favour of the licensee and stems from the patent right. Like it was already stressed above, via exclusive licence "a licensee accedes into the position previously held by a licensor in respect of the exclusive rights to commercially use invention within the specified territory." The licensee is thus entitled to restrict direct exports of patented goods undertaken by licensees for other territories relying upon the authorities conveyed to him by the exclusive licence. Otherwise, the licence would not be so exclusive. Nonetheless, the exclusive licensee is not availed with the power to restrict activities of parallel importers.

Plainly, in relation to the free movement of goods policy, *the exclusive licence, in so far it constitutes desirable deal, is liable to restrict unauthorized direct export, whilst it is always inefficient against the parallel importation.*

In more general terms conceived, *exclusive patent licences are capable to restrict free trade, save that they pass two tests:*

- *their intended effects on third parties must not exceed those appreciated by the specific subject matter of the patent right;*
- *they must not infringe the competition rules of the Common Market.*

Attempts to restrict direct exports are liable to pass first test, still they can fail on second due to prevailing circumstances of each case. Agreements that promote

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restrictions, which are prohibited. Furthermore, this Regulation has introduced new ramification discerning situations "where the undertakings party to the agreement are competing undertakings" from those where they are not. As a result, exclusive licences to ensure the exclusivity of territories are generally prohibited to undertakings from the first rank if they are engaged in a "reciprocal agreement"; defined as "a technology transfer agreement where two undertakings grant each other, in the same or separate contracts, a patent licence, a know-how licence, a software copyright licence or a mixed patent, know-how or software copyright licence and where licences concern competing technologies or can be used for the production of competing products." The undertaking of the licensor not to license technology to another licensee in a particular territory is, nevertheless, preserved to them.

In relation to the exclusive territorial licences, the position "non competitors" and competing undertakings engaged in "non-reciprocal agreement" is more or less unchanged from that of previous Regulation. (All quoted from: <http://europa.eu.int/eur-lex/lex/LexUriServ/LexUriServ.do?uri=CELEX:32004R0772:EN:HTML, 27/04/05>).

the competition and technology transfer and allow for a fair share of the resulting benefits to consumers are to be tolerated, unless they do not pose unreasonable restraints on that way. Nonetheless, *exclusive licences, which attempt to restrict any consequent parallel importation will be automatically void against the Rules of Competition and may lead to penalties.*<sup>99</sup>

## CONCLUSION

Securing outcomes that are proportionate to the aim of protection, a universal wisdom in policy of shaping intellectual property law is a ground zero from which everything starts and ends. The aim of IP policy, as it was already stressed above, is to warrant a fair value for intellectual effort and investment of capital and labour. The underlying logic is that the inventors, devisers, artists, etc. have natural right to yield upon their efforts, not the others. Yet, the outcomes of that policy, in return, are to be valued in relation to purposes of workable competition, not otherwise. To this end, though, the workable competition is a tool and criteria against what is perceived whether the free enterprise market fulfils its role, which is to ensure that macroeconomic goals are being met (economical growth, employment, optimal utilization of productive resources and potentials, stable prices and elimination of price differential etc.).<sup>100</sup> The free enterprise market is based upon freedom of entrepreneurship, free competition and free factor mobility. Therefore, the "fair value" of IP protection is to be judged in relation to these goals and elements.

The same is true in the context of the European integration. In absence of communitarian legislation, however, it has been for the European Court of Justice to draw the line between the fair and unfair scope of intellectual property rights under regime of the Common Market. The Court has done so, by acting in a manner that any national court would do when the integrity of national market is in question. Thus, in order to overcome territoriality of intellectual property law, it introduced the Communitarian-wide exhaustion of intellectual property rights rule that ignores national borders within the Common Market. The principle mainly favours the free trade and limits intellectual property rights. In other words it precludes isolation of national markets by means of IPR to the cross-border circulation of protected goods that originate from a right holder. Still, the principle preserves ability of the right holder to control direct competition. In the domain of patent rights that means

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99 W. Cornish & D. Llewelyn, *Intellectual Property: Patents, Copyright, Trade Marks and Allied Rights*, (London, Sweet & Maxwell, 2003.) para. 1-58.

100 S. M. Marković, *Patentno pravo* (Belgrade, Nomos, 1997) p. 35, 36.

that the rule does not prevent the patent holder to use the patent as an instrument to prevent circulation of goods previously produced unauthorized, notwithstanding whether it was done through direct exports or parallel importation. In other words the communitarian rule of exhaustion does not preclude patent rights to be an instrument to control competition on the level of technologies. Nevertheless, it does not tolerate suppression of independent distributors either.

From the legal point of view the right holder is in the analogous position to the one that he was in the most national markets. After he had had first release of patented goods or had consented that, he would not be able to control their subsequent circulation within the national market. Still he could prevent their reimports from elsewhere. Now, *mutatis mutandis*, it is the same only that now the "national market" is rather communitarian and "from elsewhere" counts for everything coming outside the European Economic Area.

However, despite successfully bypassing national patent law systems, the catch-all communitarian rule, nevertheless, fails to unify them or at least approximate. As a result, national laws are left to vary in scope and procedures, which itself leaves substantial amount of legal uncertainty to the players within the internal market. Therefore the appropriate directive (approximation) and regulation (unification) are needed to rectify these setbacks to the Common Market.

Finally it should be noted that the scope of "exhaustion" rule is not free from doubts. For example, formula is clear when it regulates relationships between patentee (licensor) and licensee in the view of economical ties relevance for the policy. Still, it is not clear whether licensees for the different territories are to be deemed as economically connected when the only tie between them is the common licensor?<sup>101</sup>

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101 In Ideal Standard case which concerns trademarks, the Court concluded that the trademark licensees for different territories, in the given circumstances, are not to be treated as economically connected, despite the "common origin" of their licence. Therefore exclusive licensee for one territory is liable to prevent flow of protected goods that originates from licensees for other territories or from the parallel importer who acquires them from the latter. Nevertheless, it should be noted that interpretation of the Community-wide exhaustion rule is to be done in accordance with the specific subject matter which can vary from one type to another of intellectual property. As a result, the trademarks protect the origin of products bearing protected sign.

Yet, if the exhaustion rule is to be more restrictive to the patent licensees that could foster the conjoint usage of different types of intellectual property as the business strategy to restrict competition. Consequently, the competition rules would have to deal with such practices.

This lives us to the conclusion one and a half centuries old, that "intellectual property is subject-matter too complex to be fashioned out of case law."<sup>102</sup>

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However, there is the hidden paradox of the rule as the Ideal Standard suggests that the original holder of intellectual property has less authority than his licensees (*IHT v Ideal Standard* [1994] 1 E.C.R. 2789).

<sup>102</sup> Cornish & D. Llewelyn, i, (London, Sweet & Maxwell, 2003.) para. 18-13.