Marquette Intellectual Property Law Review

Volume 11 | Issue 2 Article 2

Intellectual Property, Competition Rules, and the Emerging Internal Market: Some Thoughts on the European Exhaustion Doctrine

Guido Westkamp

Queen Mary Intellectual Property Research Institute, Centre for Commercial Law Studies, Queen Mary, University of London.

INTELLECTUAL PROPERTY, COMPETITION RULES, AND THE EMERGING INTERNAL MARKET: SOME THOUGHTS ON THE EUROPEAN EXHAUSTION DOCTRINE

GUIDO WESTKAMP*

* Senior Lecturer in Intellectual Property, Queen Mary Intellectual Property Research Institute, Centre for Commercial Law Studies, Queen Mary, University of London. Ph.D. (Münster); LL.M. (London). Email: g.westkamp@qmul.ac.uk. The author has provided translations for German and other foreign language sources.

INTRODUCTION

The doctrine of exhaustion plays an important role in European intellectual property law to preserve the free movement of products protected by intellectual property rights. However, despite the seemingly uncomplicated principles of this doctrine, a high degree of uncertainty as to its proper doctrinal foundations persists as it is applied in a variety of different legal contexts. This Article traces the application of the doctrine of exhaustion through the different legal contexts in which it is applied, assesses the status of the doctrine, evaluates the interpretation and scope of the doctrine within European Community law,[1] and aims to highlight pertinent issues regarding the doctrine in relation to both domestic and cross-border issues. The history of the treatment of the doctrine of exhaustion evidences a remarkably complex structure: the formulation of the exhaustion rule under Article 30 EC[2] was subsequently incorporated into secondary intellectual property legislation, and the European exhaustion rule was implemented into national laws. This has made it difficult to formulate more refined rules governing licensing provisions restricting the free circulation of goods. This has also resulted in uncertainty as to the proper definition of the exhaustion rule and its guiding principles. As discussed in this Article, it has also resulted in an unintelligible equation between the basic freedoms to provide, on the one hand, trade and services under European Community law and, on the other hand, to provide classification of economic rights in intellectual property.

I. THE EMERGENCE OF THE EXHAUSTION RULE

Article 28 EC incorporates the principle of free movement of goods, and it prohibits quantitative restrictions on imports between Member States and all other measures of equivalent effect.[3] Under Article 30 EC, however, national law may derogate from the principle of free movement of goods if the measure in question is justified and proportional in relation to the impact of the prima facie contravention of Articles 28 and 29 EC and the specific objective the national rule seeks to accomplish.[4] In relation to intellectual property cases, the

1. *See* Treaty Establishing the European Community, Nov. 10, 1997, 1997 O.J. (C 340) 3 [hereinafter EC Treaty].

2. EC Treaty art. 30.

3. *See id.* art. 28.

4. *Id.* arts. 28–30; *see* Case 120/78, Rewe-Zentral AG v. Bundesmonopolverwaltung für Branntwein (*Cassis de Dijon*), 1979 E.C.R. 649.

European Court of Justice (ECJ) has established that a violation of Article 28 EC may be justified only if the existence of the right is concerned,[5] which was later specified so as to relate to the specific subject matter.[6] The doctrine of exhaustion has been employed as to underpin these distinctions.[7]

Intellectual property lawyers often deem the jurisprudence regarding the interface of intellectual property and the principle of free movement of goods as an unswerving interpretation of the proprietary scope of territorial intellectual property rights within a European context. Thereby, this perception has created a notion that precludes any derogation from the principle of free movement of goods. One reason for such a result is the lowest common denominator solution, as formulated by the ECJ in relation to territorial restrictions. The free circulation of goods is consistently favored.

These various issues share common ground: most of the uncertainties concerning the application of the exhaustion rule stem from the ambiguities that exist regarding the status and treatment of intellectual property rights under European law. Under national laws, intellectual property rights remain territorial, theoretically allowing for restrictions in relation to preventing parallel and reimports and, to a certain degree, allowing for restrictions on the product market in which protection may be offered.[8] The ECJ has applied the provisions on contractual restrictions on European Community trade[9] as well as the free movement of goods principle[10] in order to curtail the control of owners of intellectual property.[11] This jurisprudence has inadvertently created a notion of exhaustion as a fundamental principle of a distinct

5. Joined Cases 56 & 58/64, Etablissements Consten, S.A.R.L. v. Comm'n, 1966 E.C.R. 299, 333–43.

6. Case 78/70, Deutsche Grammophon Gesellschaft mbH v. Metro-SB-Großmärkte GmbH & Co. KG, 1971 E.C.R. 487, 499–500.

7. *Id.* at 498–99; *Etablissements Consten*, 1966 E.C.R. at 338.

8. *See infra* Part IV.

9. EC Treaty art. 81.

10. *Id.* arts. 28–30.

11. For an application of the provisions on competition law, see *Etablissements Consten*, 1966 E.C.R. 299. *See also* Case 40/70, Sirena v. Eda, 1971 E.C.R. 69. A variety of cases have also applied the provisions of Articles 28 through 30 EC (formerly Articles 30–36). *See* Case 9/93, IHT Internationale Heiztechnik GmbH v. Ideal-Standard GmbH, 1994 E.C.R. I-2789; Case 19/84, Pharmon BV v. Hoechst AG, 1985 E.C.R. 2281; Case 144/81, Keurkoop BV v. Nancy Kean Gifts BV, 1982 E.C.R. 2853; Case 187/80, Merck & Co. v. Stephar BV, 1981 E.C.R. 2063; Joined Cases 55 & 57/80, Musik-Vertrieb Membran GmbH v. GEMA, 1981 E.C.R. 147; Case 15/74, Centrafarm BV v. Sterling Drug Inc., 1974 E.C.R. 1147.

"European intellectual property law."[12] The interpretation of this jurisprudence as establishing a rather rigid exhaustion rule has, thus, led to the reformulation of a European exhaustion principle in secondary legislation, which—in the case, for example, of directives—is then transformed into the body of national laws. However, it remains an open question as to whether the ECJ truly established rules pertaining to intellectual property rights that inadvertently—or, at least, reflexively—have led to a higher degree of harmonization.

This Article argues that this is not the case. The exhaustion doctrine has been utilized as a pattern of argument by the ECJ to arrive at decisions that maintain the underlying aim of establishing a common market. In this regard, this Article undertakes analyses of the status of the exhaustion rule as applied in different scenarios in order to identify the rule's boundaries.

The application of the exhaustion rule, as established by the ECJ, concerns the loss of control in the exercise of distribution or importation rights over subsequent acts of distribution. The assessment of the exercise of intellectual property rights does not pose many difficulties. The ECJ, early on, purported that it was competent to scrutinize the exercise of intellectual property rights; the existence of intellectual property rights, however, remained a matter of national law and was not to be called into question.[13] Although this distinction between the ECJ's role with respect to issues of the exercise versus the existence of intellectual property rights met with substantial criticism for being too vague and tautological—indeed, a right that exists but cannot be freely exercised is a *nudum ius*—the systematic approach of the ECJ merely evidences that the conflict must be resolved under the existing language of Articles 28, 29 and 30 EC.[14]

In order to frame the current debate regarding the status of the exhaustion doctrine, a brief historical outline of the ECJ's treatment of territorial intellectual property rights is in order. The first cases to

12. This is evidenced, in particular, by the inclusion of the exhaustion principle as applicable to physical goods placed in the market. The restriction of the exhaustion principle to intra-Community trade has since been established in case law. Case 479/04, Laserdisken ApS v. Kulturministeriet, 2006 ECJ CELEX LEXIS 447 (Sept. 12, 2006).

13. Initially, commentators expressed doubts as to whether the European Community was permitted to restrict the exercise of intellectual property rights given the general property safeguards under Article 295 EC (formerly Article 222). *See* Friedrich-Karl Beier, *Industrial Property and the Free Movement of Goods in the Internal European Market*, 21 INT'L REV. INTELL. PROP. & COMPETITION L. 131 (1990).

14. Karen Banks & Giuliano Marenco, *Intellectual Property and the Community Rules on Free Movement: Discrimination Unearthed*, 15 EUR. L. REV. 224 (1990).

address the interaction between the EC Treaty provisions and the exercise of territorial intellectual property rights regarding the scope and effect of exclusive licensing agreements were resolved under the rules on competition law, in particular Article 81(1) EC (formerly Article 85(1)).[15] The ECJ emphasized that license agreements containing territorial restriction clauses, which allowed the owners of the intellectual property rights to prevent reimports, violated the rules on competition.[16] In the absence of an "agreement," as required under Article 81 EC, the ECJ eventually began to apply the provision on the free movement of goods. Article 28 EC (formerly Article 30) prohibits Member States from imposing "[q]uantitative restrictions on imports and all measures having equivalent effect."[17] The ECJ has consistently determined, for example, that attempts to exercise intellectual property rights on the strength of their territorial effect constituted such equivalent effect.[18]

Article 30 EC (formerly Article 36) then allows a derogation from the principle of free movement of goods for the protection of industrial property.[19] However, when first applied by the ECJ, the derogation for industrial property rights did not provide a blanket justification for every conceivable exercise of a national intellectual property right. In the context of the derogation provided for under Article 30 EC, the ECJ generally instituted a balancing test—this balancing test then later provided the basis for the European exhaustion doctrine. In order to demarcate the boundaries between a permitted exercise of an intellectual property right and the concerns of the internal market, the ECJ initially based its decisions on the distinction between the existence and exercise of intellectual property rights. It held that, whereas the existence of rights remained unfettered by European Community law, the ECJ was competent under the EC Treaty to evaluate the exercise of such rights.[20] Such "exercise" was, in turn, to be evaluated in accordance with the specific subject matter test; accordingly, derogations from the free movement of goods principle could only be

15. *See* EC Treaty art. 81(1).

16. Case 170/83, Hydrotherm Gerätebau GmbH v. Compact del Dott. Ing. Mario Andreoli, 1984 E.C.R. 2999; Case 58/80, Dansk Supermarked A/S v. A/S Imerco, 1981 E.C.R. 191; *Sirena*, 1971 E.C.R. 69; *Etablissements Consten*, 1966 E.C.R. 299.

17. EC Treaty art. 28.

18. Joined Cases 55 & 57/80, Musik-Vertrieb Membran GmbH v. GEMA, 1981 E.C.R. 147.

19. *See* EC Treaty art. 30.

20. *See, e.g.*, Case 16/74, Centrafarm BV v. Winthrop BV, 1974 E.C.R. 1183.

justified to the extent that the exercise of intellectual property rights was within the "essence" of the right,[21] giving the ECJ an extremely flexible tool with which to overcome the adverse effects of territorial intellectual property rights and, thus, giving preference to the free movement of goods principle. Hence, once the exercise of a national intellectual property right could not be considered to be necessary in order to maintain the specific subject matter or essence of the right, the right holder was no longer permitted to rely on it and, consequently, any further control was curtailed and deemed an improper exercise of such a right.[22] Thereafter, the actual concept of exhaustion was first expressed—as far as can be discerned by this author—in the 1978 case of *Hoffmann-La Roche & Co. AG v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH*.[23]

A. Territorial Restrictions and Competition Law

The two main block exemptions dealing with intellectual property rights—the Technology Transfer Regulation (TTR)[24] and the Vertical Restraints Regulation (VRR)[25]—may indirectly affect the scope of the European exhaustion doctrine in that they permit certain degrees of territorial protection. The existence of two divergent block exemptions,

21. *See* Case 78/70, Deutsche Grammophon Gesellschaft mbH v. Metro-SB-Großmärkte GmbH & Co. KG, 1971 E.C.R. 487. Later cases also defined "specific subject matter" with regard to trademarks. *See* Case 102/77, Hoffmann-La Roche & Co. AG v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH, 1978 E.C.R. 1139 (considering the essential function of the trademark to be the guarantee of origin to the consumer or ultimate user); *Centrafarm*, 1974 E.C.R. 1183 (securing the guarantee to market the product for the first time).

22. The issue of what constitutes a proper exercise of such a right is a matter of law for the ECJ to decide. *See* Case 144/81, Keurkoop BV v. Nancy Kean Gifts BV, 1982 E.C.R. 2853.

23. *Hoffmann-La Roche*, 1978 E.C.R. 1139. The ECJ did not, however, introduce the exhaustion principle as a novel, conceptual approach; rather, it stated that the principle had already existed in case law related to Article 30 EC. *Id.* Subsequent case law then consistently and expressly reaffirmed the exhaustion rule. *See* Case C-200/96, Metronome Musik GmbH v. Music Point Hokamp GmbH, 1998 E.C.R. I-1953; Case C-352/95, Phytheron Int'l SA v. Bourdon SA, 1997 E.C.R. I-1729; Joined Cases C-267 & 268/95, Merck & Co. v. Primecrown Ltd., 1996 E.C.R. I-6285; Joined Cases C-427, 429 & 436/93, Bristol-Myers Squibb v. Paranova A/S, 1996 E.C.R. I-3457; Case 9/93, IHT Internationale Heiztechnik GmbH v. Ideal-Standard GmbH, 1994 E.C.R. I-2789; Case 395/87, Ministère Pub. v. Tournier, 1989 E.C.R. 2521; Case 341/87, EMI Electrola GmbH v. Patricia Im, 1989 E.C.R. 79; Case 35/87, Thetford Corp. v. Fiamma, 1988 E.C.R. 3585; Case 19/84, Pharmon BV v. Hoechst AG, 1985 E.C.R. 2281.

24. Commission Regulation 772/2004, 2004 O.J. (L 123) 11 (EC) [hereinafter 2004 TTR].

25. Commission Regulation 2790/1999, 1999 O.J. (L 336) 21 (EC) [hereinafter VRR].

which may potentially cover intellectual property provisions, leads to a high level of uncertainty in the application of the prevailing principles of law. Under the new 2004 TTR, qualifying contractual restraints are no longer "white-listed," as they had been under the 1996 TTR.[26]

In regards to the issue of exhaustion, the 2004 TTR revises the language of the 1996 TTR, which had outlined the application of the provisions to circumstances including "a reservation by the licensor of the right to exercise the rights conferred by a patent to oppose the exploitation of the technology by the licensee outside the licensed territory."[27] This clause was outlined in Article 2(1)(14) of the 1996 TTR and interpreted as an exclusion of exhaustion between licensor and licensee.[28] If this were true, it might signify a shift in the notion of the European exhaustion doctrine.

B. Technology Transfer and Vertical Restraints

The 1996 TTR permitted certain types of territorial restrictions.[29] The 1996 TTR, however, was repealed by the 2004 TTR,[30] and the 2004 TTR now follows a rather open regime in that it permits *any* territorial restriction provided that certain preconditions are met.[31] The new regulation has a wider scope of application in that it covers software licenses as well as patent and know-how licensing agreements.[32] Article 81(1) EC[33] is now inapplicable provided that the licensor does not enjoy a market share of more than thirty percent of the relevant product and technology market, or, in the case of competing undertakings, the

26. *Compare* 2004 TTR, *supra* note 24, *with* Commission Regulation 240/96, art. 10(1)–(4), 1996 O.J. (L 31) 2 (EC) [hereinafter 1996 TTR].

27. *See* 1996 TTR, *supra* note 26, art. 2(1)(14).

28. STEVEN D. ANDERMAN, EC COMPETITION LAW AND INTELLECTUAL PROPERTY RIGHTS: THE REGULATION OF INNOVATION 97 (1998); VALENTINE KORAH, AN INTRODUCTORY GUIDE TO EC COMPETITION LAW AND PRACTICE 298 (7th ed. 2000). The 2004 TTR apparently allows for territorial reservation for buyers. *See* VALENTINE KORAH, AN INTRODUCTORY GUIDE TO EC COMPETITION LAW AND PRACTICE 287 (8th ed. 2004) [hereinafter KORAH, GUIDE].

29. KORAH, *supra* note 28, at 298.

30. *Compare* 2004 TTR, *supra* note 24, *with* 1996 TTR, *supra* note 26.

31. The 1996 TTR only prohibited restrictions on passive sales. It permitted a ban on the licensor from licensing third parties in the licensee's territory and a ban on the licensor's exploitation of the patent and know-how in that territory. *See* 1996 TTR, *supra* note 26, art. 1(1)(1)–(2). Regarding open exclusive licenses, see Case 258/78, Nungesser KG v. Comm'n, 1982 E.C.R. 2015. *See also* 1996 TTR, *supra* note 26, art. 1(1)(4) (allowing certain territorial restrictions against competing licensees in territories within the common market).

32. 2004 TTR, *supra* note 24, art. 1(b).

33. EC Treaty art. 81(1).

parties do not have a combined market share of more than twenty percent of the relevant markets.[34]

Article 4 of the 2004 TTR contains a "black list" of exceptions relating to certain types of market separations and prohibitions on subsequent innovations.[35] A rigid market share approach, however, is prone to cause problems. Determining the correct market share in the case of new technology markets is extremely intricate, and new technologies will easily lead to a significant market share—in the case of software, it may well be argued that new applications will render the licensor dominant even for the entire life of the product. The effect will be to advise caution because a proper definition of markets for technological products or information markets is far from clear.[36]

The TTR allows for closed, exclusive licenses.[37] Accordingly, a licensee may be restricted from selling directly in to the licensor's territory.[38] Such a territory is not defined by borders, but encompasses all territories in which the licensor exploits the invention, which includes territories for which the licensor has appointed a wholesaler.[39] Direct sales undertaken by a licensee in to any such territory would, therefore, constitute a breach of contract. The 2004 TTR now distinguishes between competing and noncompeting undertakings.[40] Where the undertaking parties are competing undertakings, they may enter into agreements under which the licensor restricts production to one territory.[41] This provision does not appear to affect parallel imports, although one may undertake to advance a position that a prohibited

34. 2004 TTR, *supra* note 24, art. 3.

35. *See id.* art. 4. Territorial restrictions do not fall within the hardcore restrictions. *Id.* art. 4(1)(c)(iv).

36. Guido Westkamp, *Balancing Database Sui Generis Right Protection with European Monopoly Control Under Article 82 E.C.*, 22 EUR. COMPETITION L. REV. 13, 16–17 (2001).

37. 2004 TTR, *supra* note 24.

38. 1996 TTR, *supra* note 26, art. 1.

39. *Id.*

40. 2004 TTR, *supra* note 24, art. 3.

> Where the undertakings . . . are competing undertakings, the exemption . . . shall apply [if] . . . the combined market share of the parties does not exceed 20% . . . . Where the undertakings . . . are not competing undertakings, the exemption . . . shall apply [if] . . . the market share of each . . . does not exceed 30% . . . .

Id.

41. *Id.* art. 4(1)(c)(ii). Provided that the licensed technology is produced within one or more technical fields of use or one or more product markets, the licensees cannot be restricted from producing for different purposes outside such territory. Commission Notice, 2004 O.J. (C 101) 2 [hereinafter TTR Guidelines].

restriction of the licensee to produce in another territory gives rise to a right to market or distribute there.[42] The reason for this is that outside the scope of a permitted production restriction—in other words, one that clearly sets out the conditions in relation to fields of use or product markets—intellectual property rights will be unenforceable and subject to scrutiny under Article 81(1) EC.[43] With respect to the issue of consent, the ECJ took the view that the license, as such, constitutes consent within the meaning of the exhaustion rule; unless the restriction is exempt, any control right over the further distribution of a protected product is relinquished between licensor and licensee.[44] The licensee can, however, be restricted from granting sublicenses outside such territory.[45] The prerogative is not limited to the same restraints as an obligation on the licensee to only produce within defined technical fields of use or product markets. It remains an open question as to whether this would affect a sublicense granted for the purpose of producing outside a field of use restriction or for a different product market. The result, if such a reading were to be adhered to, would be absurd: the licensor can only effectively restrain a licensee from expanding the contractual scope to "new" uses, but cannot prevent the same if the licensee has granted a sublicense.

Under the VRR, a seller of products may impose restrictions on active sales in to territories reserved to third-party buyers and may also reserve territories to himself or herself.[46] The VRR affects intellectual property rights only to the extent that they are ancillary provisions in relation to a distribution agreement.[47] It is uncertain whether this provides for the cumulative application of the VRR in cases where a clause is not included under the TTR—by some commentators, this is

42. *See* 2004 TTR, *supra* note 24, art. 4.

43. *Id.*; *see* EC Treaty art. 81(1).

44. Case 102/77, Hoffmann-La Roche & Co. AG v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH, 1978 E.C.R. 1139.

45. *See* TTR Guidelines, *supra* note 41, at 17.

46. Under Article 4(b) of the VRR, a seller may restrict

> the territory into which, or of the customers to whom, the buyer may sell the contract goods or services, except:
>
> > the restriction of active sales into the exclusive territory or to an exclusive customer group reserved to the supplier or allocated by the supplier to another buyer, where such a restriction does not limit sales by the customers of the buyer.

VRR, *supra* note 25, art. 4(b).

47. The term "ancillary" was interpreted to mean that the intellectual property right must not constitute the main object of the contract. *See* Case T-112/99, Métropole Télévision v. Comm'n, 2001 E.C.R. II-2459.

perceived as *lex specialis*.[48] This requires a rather artificial distinction, especially in cases where the object of intellectual property protection in question is not entirely clear: an agreement, for example, pertaining to the sale of a computer video game would be captured under the TTR, if the main object of the contract concerned distribution rather than licensing.

II. BLOCK EXEMPTIONS AND EXHAUSTION

The traditional view of both the European Commission and the ECJ has been rather hostile toward the effects of territorial market partitioning.[49] The view adopted by the ECJ has persistently referred to the overarching aim of establishing a common market.[50] To that end, the ECJ has scrutinized licensing agreements under Article 81(1) EC and, if that provision was determined to be inapplicable, it has additionally analyzed the compatibility of the agreement with the principle of the free movement of goods.[51] In all cases, the ECJ has relied on the exhaustion of intellectual property rights.[52] In that sense, both competition rules and the free movement of goods principle are

48. VRR, *supra* note 25, recital (3).

> This category includes vertical agreements for the purchase or sale of goods or services where these agreements are concluded between non-competing undertakings, between certain competitors or by certain associations of retailers of goods; it also includes vertical agreements containing ancillary provisions on the assignment or use of intellectual property rights . . . .

Id.

49. Commission Decision 76/29, 1976 O.J. (L 6) 8; Commission Decision 75/570, 1975 O.J. (L 249) 27. The ECJ has allowed open exclusive licenses. Case 258/78, Nungesser KG v. Comm'n, 1982 E.C.R. 2015. Likewise, the Patent Licensing Regulation only allowed nonexclusive and open exclusive licenses. *See* Commission Regulation 2349/84, art. 1(1)(1)–(5), 1984 O.J. (L 219) 15. *See generally* KORAH, *supra* note 28, at 283.

50. Case 19/84, Pharmon BV v. Hoechst AG, 1985 E.C.R. 2281; Case 96/75, EMI Records Ltd. v. CBS Schallplatten GmbH, 1976 E.C.R. 913; Case 78/70, Deutsche Grammophon Gesellschaft mbH v. Metro-SB-Großmärkte GmbH & Co. KG, 1971 E.C.R. 487.

51. EC Treaty arts. 28–30, 81(1).

52. The ECJ established that Article 36 EC (now Article 30) does not restrict the scope of application of the competition provisions. *See* Joined Cases 56 & 58/64, Etablissements Consten, S.A.R.L. v. Comm'n, 1966 E.C.R. 299. The ECJ later applied Article 36 EC, by way of analogy, to cases concerning Article 85 EC (now Article 81). *See* Case 24/67, Parke, Davis & Co. v. Probel, 1968 E.C.R. 55. Then, it directly applied Articles 30 through 36 EC (now Articles 28–30) to any exercise of intellectual property rights. *See* Case 16/74, Centrafarm BV v. Winthrop BV, 1974 E.C.R. 1183; Case 192/73, Van Zuylen Frères v. Hag AG, 1974 E.C.R. 731; *Deutsche Grammophon*, 1971 E.C.R. 487; Case 40/70, Sirena v. Eda, 1971 E.C.R. 69.

taken into account in securing the overarching aim of establishing a common market.

In apparent contrast to the traditional position on exhaustion, Article 2(1)(14) of the 1996 TTR indicated that sales contravening white-listed territorial restrictions could be prevented by the owner.[53] Consequently, exhaustion would not occur, and, in other words, the licensor would be permitted to prevent parallel imports.[54] There is no guidance, however, under the 2004 TTR, which relies upon a market threshold approach, although, under Article 4, a territorial reservation by the licensor is still possible.[55] The language of Article 2(1)(14) of the 1996 TTR preserves for the patentee the right to "oppose" the exploitation outside the licensed territory,[56] and the provision expressly refers to the "rights conferred by a patent."[57] Likewise, as outlined in Part I.B, the VRR includes provisions for territorial restrictions and may alternatively apply.[58]

If the licensor is permitted to introduce territorial restrictions upon the licensee, the question still remains as to whether the licensor can enforce his or her intellectual property rights in cases where the licensee—or, in cases applying the VRR, the licensee-distributor—has put goods on the market despite a valid contractual restriction.

A. Scope of Application for Intellectual Property Rights

Territorial restrictions on the resale of protected products may be exempt under either the VRR or the TTR.[59] In relation to licenses for intellectual property rights, however, the scope of applicability and relationship between the TTR and VRR are not entirely clear. The TTR applies to licenses of patents and similar subject matter that the European Commission deems to be within the realm of technology transfer.[60] Such agreements cannot, however, be simultaneously exempt under the VRR.[61]

53. Article 2(1)(14) provides for "a reservation by the licensor of the right to exercise the rights conferred by a patent to oppose the exploitation of the technology by the licensee outside the licensed territory." 1996 TTR, *supra* note 26, art. 2(1)(14).

54. *See id.*

55. *See* 2004 TTR, *supra* note 24, art. 4.

56. *See* 1996 TTR, *supra* note 26, art. 2(1)(14).

57. *Id.*

58. *See* VRR, *supra* note 25, art. 4(b).

59. *See* 2004 TTR, *supra* note 24; VRR; *supra* note 25.

60. *See generally* 2004 TTR, *supra* note 24.

61. *See* VRR, *supra* note 25, art. 2(1).

A patentee may grant a license to manufacture and sell the patented invention in one territory, market the patent himself or herself, or appoint an exclusive dealer. In each of these situations, different block exemptions apply. One related problem that has since been addressed by the 2004 TTR is that the 1996 TTR afforded a lesser degree of protection depending on whether the legal relationship fell within the TTR or the VRR.[62] It followed that an agreement that merely constituted a distribution contract was outside the scope of the TTR, even though it might have included a patent license. Such a license is generally required because the act of selling constitutes the exercise of an exclusive right. However, the contract may also simply contain an obligation under which the owner of the patent impliedly waives his or her right to exercise any propriety rights. From Article 5 of the 2004 TTR, it follows that a contract relating to the supply of a patented product is not covered under the TTR since the recitals state that the act of exploitation is the main goal for fostering new technologies.[63] Conversely, the VRR block exemption does not apply to contracts that have as their primary object the assignment or license of an intellectual property right.[64]

The VRR does not apply to vertical agreements in which the respective provisions on intellectual property are not ancillary.[65] Because the VRR covers distribution agreements, it follows that a license introduced simply to allow the sale in the protected territory constitutes an ancillary provision. The true scope of the term, however, still remains obscure. Sole supply licenses are covered, although they were, likewise, excluded under the former TTR.[66] Under the VRR, intellectual property licenses can be part of a vertical agreement as long as they do not constitute the primary object.[67] The term is not defined in the VRR, but it may be asserted that such an objection would merely exclude those agreements to which the TTR applied anyway—that is,

62. For instance, a buyer could be given protection from direct sales by other buyers into his or her own territory under the VRR, but could not be protected from sales by a licensee, such as a manufacturer. *Compare* VRR, *supra* note 25, art. 4(6), *with* 1996 TTR, *supra* note 26, art. 1(1)(5).

63. *See* 2004 TTR, *supra* note 24.

64. *See* VRR, *supra* note 25, art. 2(3).

65. *See* Commission Notice, 2000 O.J. (C 291) 1 [hereinafter VRR Guidelines]; *see also* VRR, *supra* note 25, recital (3).

66. 1996 TTR, *supra* note 26, art. 5.

67. VRR, *supra* note 25, arts. 2(3), (5).

licenses that are intended for exploitation or manufacture by the licensee.[68]

Therefore, vertical agreements related to other intellectual property rights are covered, provided that the license remains ancillary so as to constitute a mere means to implement the contract for supply.[69] Hence, under Article 2(3) of the VRR, a contract for the supply of patented goods for sale falls within the scope of the provisions.[70] It also follows that these criteria must apply in relation to all other forms of intellectual property including, for example, copyright.

A different approach to concluding whether certain intellectual property licenses in vertical agreements are covered by the VRR is to analyze the relationship between Article 2(1), which refers to all vertical agreements, and Article 2(3), which allows for the inclusion of ancillary intellectual property rights.[71] The main issue here is whether Article 2(3) excludes any other intellectual property agreements—that is, pure licenses that are not ancillary, but also include the characteristics mentioned in Article 2(1).[72] One view is to permit certain intellectual property-related contracts to fall within the ambit of Article 2(1), thus invoking the application of the block exemption.[73] The main concern thereby being to address the absence of a group exemption, particularly for franchising agreements and copyright licenses.[74]

The contrary view, under which Article 2(3) is considered a *lex specialis* to Article 2(1), would force the conclusion that intellectual property licenses, as such, cannot be covered unless they are ancillary.[75] The solution to be found amongst these countervailing views is perhaps found in considering that it is almost impossible to draw a distinction between an ancillary and a non-ancillary provision relating to intellectual property rights if one disregards the intention of the parties and places emphasis instead solely on the fact that intellectual property rights have been licensed. Under such an approach, a more balanced view may be taken: the applicability of the VRR depends on the

68. KORAH, *supra* note 28, at 248.

69. *See* VRR Guidelines, *supra* note 65, at 9.

70. VRR, *supra* note 25, art. 2(3).

71. *Id.* arts. 2(1), (3).

72. *Id.*

73. *Id.*

74. VALENTINE KORAH & DENIS O'SULLIVAN, DISTRIBUTION AGREEMENTS UNDER THE EC COMPETITION RULES 143 (2002).

75. Case 161/84, Pronuptia de Paris GmbH v. Pronuptia de Paris Irmgard Schillgallis, 1986 E.C.R. 353; *see* KORAH & O'SULLIVAN, *supra* note 74, at 143.

proximity of a contract to a vertical supply agreement rather than to a license. The TTR is, thus, *lex specialis* in relation to contracts regarding technology transfers because such contracts require a more generous scope of exemption. The scope of restrictions in relation to territory, substance, and time exceed those of the VRR. Licenses relating to other types of intellectual property, such as copyright, therefore, cannot be exempt under the VRR if the licenses go beyond the scope of the supply of other types of intellectual property, particularly if these contracts relate to the manufacture of the protected product.[76]

But even if Article 2(3) of the VRR is not interpreted so as to restrict the entire scope of application to ancillary intellectual property provisions, a more flexible approach considering the reasons why the TTR does not apply to sole supply agreements still proves instructive.[77] The manufacturer must develop and invest in manufacturing devices. This investment makes it more difficult to penetrate the market. In addition, because the TTR generally relates to new technology, it is more difficult for licensees to acquire a market altogether.[78] The licensees not only have to bear investment costs, but also higher risks—both risks that are normally not present in agreements relating to supply and resale. For these agreements, however, the licensees and licensors can agree on rather extensive protectionist terms.

In relation to copyrighted software, for example, it is suggested that a licensing agreement pertaining to distribution can be exempt under the VRR if the software license relates primarily to distribution of the physical software. The licensee—for instance, a wholesaler—may then need a simple license to run the program based upon the right to temporarily make a reproduction in accordance with Article 4(a) of the European Software Directive.[79] Hence, a distribution agreement that entails the right of the licensee to adapt or develop the software can fall under the VRR because the reproduction right granted has no individual economic significance in relation to the distribution.[80] The same may be true in relation to contracts regarding the subsequent update of databases by licensees.[81] Because the 2004 TTR now allows

76. *See* 2004 TTR, *supra* note 24; VRR; *supra* note 25.

77. *See* 1996 TTR, *supra* note 26, art. 10(15) (defining "ancillary provisions" as related to exploitation).

78. *See id.*

79. *See* Council Directive 91/250, 1991 O.J. (L 122) 42.

80. *See id.*

81. *See id.*

for the inclusion of software copyrights[82] but not database copyrights or rights subsisting under Article 7 of the European Software Directive,[83] the final categorization of such contracts remains dubious and adds to the legal uncertainty regarding technology-related copyrights.

Applying a more restrictive reading of the term "ancillary," a different result will follow in relation to trademark licenses for franchising purposes. If a franchisee does not have to bear substantial investment costs due to an established market reputation for the goods or services protected by the mark, one may deduce that the agreement is being concluded in relation to an existing market. Here, the transfer of trademarks is a more substantial component of the agreement because without the established reputation, the parties would not have entered into the agreement. Consequently, the trademark does not constitute an ancillary right, but rather is the very primary object. This may transpire entirely differently in relation to registered marks, which have not yet acquired market reputation. In short, the importance of reputation, as reflected in the respective trademark, will determine whether the VRR applies.[84]

The 2004 TTR strictly adheres to market shares rather than relying on licensing clauses.[85] An important distinction is made between competing and noncompeting undertakings. In general, the TTR applies to competing undertakings if the combined market share does not exceed twenty percent of the relevant technology and product market; in the case of noncompeting undertakings, the threshold has been set at thirty percent.[86] In effect, this approach forces a significant number of major undertakings back into the realm of Article 81(1) EC and will also affect small and medium-sized enterprises (SMEs), which rely heavily upon the production of specialized products.[87] The

82. *See* 2004 TTR, *supra* note 24.

83. *See* Council Directive 91/250, *supra* note 79, art. 7.

84. *See generally* VRR, *supra* note 25.

85. *See* 2004 TTR, *supra* note 24.

86. *See id.* art. 3.

> For technology transfer agreements between non-competitors it can be presumed that, where the individual share of the relevant markets accounted for by each of the parties does not exceed 30% and the agreements do not contain certain severely anti-competitive restraints, they generally lead to an improvement in production or distribution and allow consumers a fair share of the resulting benefits.

Id. recital (11).

87. *See* EC Treaty art. 81(1). It has already been argued that the "market share" approach—rather than an approach based on substantive terms—is counterproductive because industries relying on innovation will, to a large extent, be above the market share

combination of factual restrictions and the additional application of the provisions on the free movement of goods will, thus, produce an understanding of the exhaustion rhetoric that is directly applicable to further sales and supports a general understanding of the exhaustion principle as a formula for shaping and adjusting national intellectual property rights. There will be grave effects: even if territorial restrictions are permissive and are perceived to be pro-competitive because they allow for recoupment of investment costs, the violation of such clauses by a licensee or buyer will only constitute a breach of contract. Such a position, however, is fallacious and factually contravenes the potentially pro-competitive effect of both technology transfer licenses and also certain other types of vertical restraints. A licensee may be so attracted by actual price differences that he or she would undertake the economic risk of contractual damages in return for a higher profit by selling into reserved territories—such a scenario is not unlikely, especially in the pharmaceuticals sector where price fixation exists.[88] It also, once again, gives rise to a high level of legal uncertainty.

If an owner of an intellectual property right may restrict distribution as a matter of European Community law, a considerable difficulty arises in relation to determining the status of such restrictions as either absolute or contractual. This issue is fundamentally identical to that which would arise under national intellectual property laws; national systems still have to employ some form of proportionality test for ensuring the free circulation of goods, and yet this must be balanced against the respective domestic notions of intellectual property and the proprietary effects of restrictive clauses. This implies that jurisdictions may differ in respect to the effect of a licensor's consent, which may or may not have an absolute effect, and, additionally, may also invoke a notion of national market freedom under which the impact of permissible restrictions on the free circulation of protected products may be curtailed. One consequence of a more open system of restraints—territorial or otherwise—is that, because market partitioning is acceptable from a European Community law perspective, the extent

because there are no real substitutes. In addition, if the VRR applies to other forms of intellectual property rights as "ancillary"—for instance, database rights—a divergent treatment of the exhaustion rule will cause concern because it differentiates on the basis of an artificial discrimination regarding subject matter. The problem has also surfaced in relation to franchising agreements, which predominantly rely upon trademark use, causing uncertainties as to whether such intellectual property rights are "ancillary."

88. *See, e.g.*, Pharmalicensing.com: EMEA and the Marketing of Pharmaceuticals Across the European Union, http://pharmalicensing.com/articles/disp/994346010_3b448 41a653f7 (last visited Apr. 10, 2007).

to which restrictive licensing clauses are permissible becomes a matter of national law.

In regard to the issue of consent, neither the jurisprudence under Article 28 EC nor the respective block exemptions disclose whether a permissible but limited consent has absolute effect.[89] This is unsurprising as both legal frameworks deal with potential distortions of the common market rather than establishing directly applicable norms for a scheme of European intellectual property licensing laws. Otherwise, the effect of permissible restrictions will become a matter of national law. It then becomes primarily an issue of controlling both distribution channels and market levels, and this, in turn, depends on the scope of contractual freedom to allow the licensor to restrict subsequent sales into reserved territories with proprietary effect.

According to the jurisprudence of the ECJ, such freedom does not exist because the European exhaustion rule does not pertain to the "first sale," but rather pertains to any prospect of recouping an investment.[90] This approach is based upon the reward theory, according to which even an acceptable territorial restriction does not protect against parallel imports. However, this inference is hardly ascertainable. It would, as a de minimis principle, axiomatically require the existence of a European exhaustion rule as a matter of intellectual property law, unequivocally demarcating the scope of contractual freedom under national law.

B. The Twofold Meaning of Consent

Thus, the first conclusion relates to the interface between permissible restraints and proprietary consent. Under both the jurisprudence on Articles 81(1) and 28 EC and the respective secondary legislation, "consent" refers to the act of putting products on the market.[91] But the scope of that rule remains rather imprecise. Territorial restrictions based on the differences between national intellectual property systems were perceived as distorting the common market.[92] For this reason, the ECJ has used the exhaustion rule so as to restrict control over subsequent sales on the basis of the act of

89. *See* EC Treaty art. 28; 2004 TTR, *supra* note 24; VRR, *supra* note 25.

90. Case 19/84, Pharmon BV v. Hoechst AG, 1985 E.C.R. 2281; Case 16/74, Centrafarm BV v. Winthrop BV, 1974 E.C.R. 1183.

91. *See* EC Treaty arts. 28, 81(1).

92. *See Pharmon*, 1985 E.C.R. 2281.

licensing.[93] Such an approach appeared legitimate in that the level of integration was rather undeveloped. Early on, the ECJ emphasized that consent was the cornerstone of its exhaustion concept, and it declined to recognize the occurrence of exhaustion in cases concerning non-voluntary acts of distribution[94] or in cases in which the goods were placed on the market outside the European Community.[95]

Whereas the meaning of consent under most national laws related to putting products on the market, the ECJ operated with the understanding that any consent was sufficient.[96] It referred to the specific subject matter of the intellectual property right in the context of Article 30 EC and concluded that the specific subject matter referred to the right of putting the product into circulation for the first time.[97] Such an act would then exhaust the right with effect for the entire European Community. It, thus, became irrelevant whether the agreement contained anti-competitive restrictions because it would be captured under Article 28 EC, which would necessarily supersede any right to prevent parallel imports.[98] The key to this analysis is the emphasis placed on "consent," which the ECJ interpreted so as to refer to the entire territory of the EC Treaty and which it equated with entering into licensing agreements, including compulsory licenses.[99] This allowed for a step back from the more restrictive requirements under Article 81 EC and also invoked a legal rule under which entering into a license agreement, as such, was sufficient. In turn, this interpretation developed into the understanding that every act of putting a product

93. *See id.*

94. *Id.*

95. *See* Case C-355/96, Silhouette Int'l Schmied GmbH & Co. KG v. Hartlauer Handelsgesellschaft mbH, 1998 E.C.R. I-4799.

96. *See* sources cited *supra* note 23.

97. *See* Joined Cases 55 & 57/80, Musik-Vertrieb Membran GmbH v. GEMA, 1981 E.C.R. 147.

98. *See* EC Treaty art. 28.

99. *See* Joined Cases C-267 & 268/95, Merck & Co. v. Primecrown Ltd., 1996 E.C.R. I-6285 (stating that the substance of a patent right was the exclusive right to put the invention on the market for the first time); Case 144/81, Keurkoop BV v. Nancy Kean Gifts BV, 1982 E.C.R. 2853; Case 187/80, Merck & Co. v. Stephar BV, 1981 E.C.R. 2063 (stating that patent law does not give a right to monopoly profits and a patentee cannot prevent reimportation of goods previously marketed in another Member State even though the invention was not patentable there); *Musik-Vertrieb*, 1981 E.C.R. 147 (holding that there is no right to additional royalties for a copyright collecting society); Case 15/74, Centrafarm BV v. Sterling Drug Inc., 1974 E.C.R. 1147 (addressing the right to first put into circulation, either directly or by an authorized party, and the right to sue for infringement); *see also* Robert M. Merkin, *The Interface Between Anti-Trust and Intellectual Property*, 6 EUR. COMPETITION L. REV. 377, 391 (1985).

into circulation resulted in exhaustion, even when the place of first circulation was a country in which no rights existed or where the owner could not be rewarded, a scenario which was held to result in rendering intellectual property rights a *nudum ius*.[100]

Territorial restrictions in licensing contracts cannot affect the occurrence of exhaustion as a matter of the proprietary scope of intellectual property rights. Such an understanding, however, presupposes that the ECJ's jurisprudence has established a true limitation on the exercise of national intellectual property rights. Consent, in this respect, was not employed as a predeterminative, normative rule, but rather constituted the principle aspect for resolving and guiding the proportionality test—mostly, but not necessarily, in favor of free circulation.[101] If this is correct, the status of consent—and, subsequently, its effects upon exhaustion—may be analyzed more closely in light of the function of intellectual property rights and, more specifically, the scope of the licensor's ability to bind his or her buyers and licensees.

The current trend is to allow restraints for non-dominant firms. This is true, at least, with respect to technology transfer rules and also under Article 81(1) EC.[102] This appears to introduce a more flexible notion of consent in that the owner of intellectual property rights is permitted to restrict subsequent sales and may stipulate certain substantive restrictions.[103] Therefore, the view may be taken that the meaning of consent as a matter of European Community law is identical to the scope of the license. Hence, a license restricting the ability of the licensee to sell into reserved territories would not additionally be subject to a compatibility test under Article 30 EC.[104] The licensor would be able to prevent exhaustion as a matter of his or her restricted consent, provided that the clause is exempt. Here, the only problem is that the block exemptions do not contain express provisions on

100. *See* Clifford G. Miller, Magill: *Time to Abandon the "Specific Subject-Matter" Concept*, 16 EUR. INTELL. PROP. REV. 415, 419 (1994).

101. The arguments raised in relation to a self-induced liability of the licensor by putting goods on the market are unconvincing because Article 30 EC relates to the restrictive practices under national law and is unconcerned with an individual's behavior. *See, e.g.*, *Merck*, 1981 E.C.R. 2063; *see also* Folkmar Koenigs, *Rechtsfolgen der Einheitlichen Europäischen Akte für den Gewerblichen Rechtsschutz*, *in* LOHN DER LEISTUNG UND RECHTSSICHERHEIT 267 (Manfred Bohlig ed., 1988).

102. Commission Decision 95/373, 1995 O.J. (L 221) 34.

103. *Id.*

104. *See id.*

exhaustion; following a more conventional approach, that might cause disparities insofar as the type of agreement is concerned.[105]

The same is true for most national intellectual property systems, which allow for restrictions unless they exceed the scope of intellectual property rights granted as a matter of competition law. Under European Community law, the issue of exhaustion is, therefore, undecided insofar as the block exemptions vary in their scope of application and their respective stances on exhaustion in cases of territorial restrictions.

C. Territorial Restrictions as Sector-Specific Exemptions on Exhaustion?

As previously noted, Article 2(1)(14) of the 1996 TTR maintains the right of a patentee to oppose exploitation outside the licensed territory.[106] The provision is interpreted so as to simultaneously imply that exhaustion does not occur.[107] Territorial restrictions will then enable the licensor to bind third parties because the necessary consent is absent—that is, they will have an absolute effect. As a matter of law, such restrictions would also, therefore, not violate Article 28 EC.

Conversely, in Europe, the exhaustion rule would generally apply under Article 28 EC with direct effect upon national intellectual property rights; in that sense, it has proprietary effect. It follows that the effect rests in restricting the scope of intellectual property rights in order to generally exclude any further control over subsequent sales. Such a position rests upon the traditional perception of intellectual property licenses as obstacles for establishing the common market; given this perception, the ECJ has exhibited subsequent hostility toward territorial restrictions.

1. Market Freedom and Differentiation of Market Levels

Under the former Patent Licensing Regulation,[108] the view was taken that the first act of licensing exhausts the right with effect for the entire territory.[109] If it were to apply to subsequent acts, the owner would be able to control subsequent sales and impose diverging levels of protection.[110] If it applied at the stage where the licensed product

105. *See supra* Part II.A.

106. 1996 TTR, *supra* note 26, art. 2(1)(14).

107. *Id.*

108. Commission Regulation 2349/84, *supra* note 49.

109. *See id.*

110. James S. Venit, *In the Wake of* Windsurfing: *Patent Licensing in the Common*

reaches the consumer, then sales prior to this could be controlled by way of national patent laws. It should be noted, however, that a striking distinction exists in European case law that appears to apply to the entirety of intellectual property rights—that is, the right to control all sales. Under national patent and copyright laws, exhaustion occurs only once the product or copy has actually been put into circulation, and the effect only applies to these specific copies; under European Community laws, exhaustion occurs without any objective circulation at the time at which the contract is entered.[111] This stance is, thus, much more restrictive, and it is suggested that the rigidity imposed by the ECJ reiterates the correctness of the functional approach.[112] In fact, by insisting on exhaustion through the act of licensing, the ECJ has adopted a view that is hardly reconcilable with the function of the exhaustion rule under national law. Thus, it remains a basic blueprint that serves to achieve a balance between the core, untouchable subject matter and the consequences of exercising intellectual property rights in relation to the common market. Consequentially, if the exhaustion rule simply exists as a collision clause, its impact will be a matter of the applicable national laws in relation to the licensing contract.

2. Potential Disparities Between Block Exemptions

The second problem this will induce is a potentially artificial exemption from exhaustion under different block exemptions. Hence, exhaustion can only be prevented under the TTR as a sector-specific exception in expressly referring to a continued sole exploitation right in reserved territories, but not, hypothetically, under the VRR.[113]

The exhaustion rule, therefore, will apply since the clause effects a barrier to trade within the meaning of Article 28 EC if the licensor evokes his or her rights in order to introduce export bans.[114] In such a case, there is no opportunity to invoke national patent rights to stop direct sales.[115] This was the position set forth under the Patent Licensing

Market, *in* 1986 FORDHAM CORPORATE LAW INSTITUTE 517, 528–29 (B. Hawk ed., 1987).

111. *See* Case 19/84, Pharmon BV v. Hoechst AG, 1985 E.C.R. 2281.

112. *Id.*

113. *See* 2004 TTR, *supra* note 24; VRR, *supra* note 25.

114. Case 258/78, Nungesser KG v. Comm'n, 1982 E.C.R. 2015.

115. *Cf.* ANDERMAN, *supra* note 28, at 98 (stating that even though a clause may be caught under Article 81(1) EC, the licensor may still be able to rely on *national* patent rights). The correct view is to treat the agreement in accordance with Article 81(1) EC, whereas the question of exhaustion in cases of illegitimate restrictions—for example, an export ban imposed between individual licensees—should be treated under Articles 28 through 30 EC.

Regulation, under which a territorial restriction would have no effect on subsequent sales into reserved territories;[116] in other words, the contractual clause—albeit, enforceable against the licensee—had no absolute proprietary effect.

As previously noted, this appears to have changed under the 1996 TTR, where Article 2(1)(14) upheld the licensors' right to oppose subsequent sales within reserved territories with absolute effect,[117] although the TTR does not mention the exhaustion principle.[118] The 2004 TTR, likewise, does not mention exhaustion, but it does permit any territorial restriction provided that the market thresholds are not exceeded.[119] If the view were to be taken that the respective block exemptions deal with the exhaustion issue, this would have a number of consequences. First, exhaustion would be a result of the applicability of either the TTR or VRR. The consequences now are apparently less grave than they would have been under the 1996 TTR, which prohibited restrictions on sales into territories reserved to other licensees;[120] the VRR now allows such territorial protection for buyers.[121] Hence, in cases of mixed supply and licensing agreement structures, if a buyer sold in a licensee's territory, the owner of the intellectual property right would not be able to prevent further sales because Article 2(1)(14) of the 1996 TTR would be inapplicable in prohibiting such territorial protections.[122] Therefore, exhaustion would have occurred once the goods had been supplied from the country of export, and the clause would be captured under Article 81(1) EC.[123] If he or she sold into another buyer's territory, such territorial protection would be permissive under the VRR provided that the intellectual property right in question is 'ancillary' to the main contract; however, because the clause is exempt under the VRR—which includes no provision similar to Article 2(1)(14) of the 1996 TTR—the general rules of exhaustion would apply. This leads to a potential inconsistency between both the provisions of the TTR and VRR.

116. *See* ANDERMAN, *supra* note 28, at 97; Venit, *supra* note 110, at 527.

117. *See* ANDERMAN, *supra* note 28, at 99; KORAH, *supra* note 28, at 298.

118. *See* 1996 TTR, *supra* note 26, art. 2(1)(14).

119. *See* TTR 2004, *supra* note 24, art. 4.

120. *See* 1996 TTR, *supra* note 26.

121. *See* VRR, *supra* note 25, recital (3).

122. As has been discussed, Article 2(1)(14) of the 1996 TTR only allowed a reservation of the licensor of his or her right conferred by a patent to oppose the exploitation by a licensee, not by a buyer of a protected product. 1996 TTR, *supra* note 26, art. 2(1)(14).

123. *See* EC Treaty art. 81(1).

Territorial restrictions within the ambit of the TTR would, therefore, prevent exhaustion between licensors and licensees, which implies that third parties may be bound under the terms of contracts based on domestic intellectual property rights. It is obvious that a licensee cannot reimport into a licensor's territory; the ensuing question, however, is whether or not the licensor can also prevent further sales by third parties. This depends on whether the respective clause is proprietary—that is, whether the control right over subsequent acts of distribution can be enforced on the basis of national intellectual property rights.[124]

If the TTR permits reservations of territories, subsequent acts of distribution at different market levels might violate Article 28 EC, despite being exempt from competition control. The answer predominantly depends upon the relationship between Articles 81 and 28 EC and the status of the exhaustion rule under the principle of the free movement of goods.[125] If Articles 81 and 28 EC are complementary in seeking to ensure a balance between pro-competitive restrictions and the free movement of goods, one may conclude either that Article 28 EC is inapplicable[126] or that the restriction can be justified under Article 30 EC, precisely because it aims to uphold the effect of intellectual property rights as an incentive.

In its traditional judicature, the ECJ has consistently determined to permit the inventor the chance of reward,[127] rather than gain a true profit;[128] such a position, however, was informed by the "first licensing" doctrine, which necessarily rendered both concepts consistent in prohibiting territorial restraints. Whether the TTR allows for the inference that European Community law may now be interpreted more extensively as enabling the licensor to recoup reward beyond the mere act of licensing is an open question.[129] A view rejecting the notion of a

124. *See* ANDERMAN, *supra* note 28, at 98.

125. *See infra* Part III.A.

126. *See infra* Part IV.A.

127. Case 15/74, Centrafarm BV v. Sterling Drug Inc., 1974 E.C.R. 1147.

128. *See* Case 187/80, Merck & Co. v. Stephar BV, 1981 E.C.R. 2063 (applying exhaustion even regardless of a factual chance of reward); *Centrafarm*, 1974 E.C.R. 1147; *see also* JÖRG REINBOTHE & SILKE VON LEWINSKI, THE EC DIRECTIVE ON RENTAL AND LENDING RIGHTS AND ON PIRACY 17 (1993) (asserting that consent refers to putting the work on the market for the first time).

129. Case 19/84, Pharmon BV v. Hoechst AG, 1985 E.C.R. 2281 (suggesting that in cases of direct sales, exhaustion should apply, thereby favoring free circulation of goods over territorial restrictions); *see also* Case 78/70, Deutsche Grammophon Gesellschaft mbH v. Metro-SB-Großmärkte GmbH & Co. KG, 1971 E.C.R. 487 (applying a similar result to copyright).

European license as a matter of competition policy[130] would signify that the TTR embraces a proprietary concept, allowing for inferences to be drawn as to the scope of intellectual property rights.

Therefore, it appears that exhaustion does not occur, at least as far as European Community law is concerned with regard to clauses falling within the TTR. In general, this viewpoint is difficult to reconcile with the conceptual framework and interface between competition law and the rules related to the free movement of goods. Within national legal frameworks, competition law is concerned with restrictions stemming from intellectual property monopolies. The normative assertion of competition law is not concerned with providing rules of a proprietary character. Initially, it cannot be asserted whether exhaustion occurs as a matter of European Community competition law. In addition, such an interpretation would give rise to uncertainties because it would depend on whether the applicable block exemption contained a provision expressly allowing for a territorial restriction as a matter of copyright or patent law, which would restrict the proprietary nature of territorial restrictions to those block exemptions primarily concerned with intellectual property licenses.

Restrictions falling within the VRR, then, ostensibly do not give rise to exhaustion and might be included under Article 28 EC. But, here, it remains open to consideration as to the following: (1) at which market level exhaustion will occur, and (2) whether the supplier of protected goods can still control further sales on the basis of national intellectual property rights. The prior jurisprudence of the ECJ is unhelpful; in most cases the ECJ held that initial consent was decisive, but the relevant case law did not deal with a situation in which an intellectual property right ancillary to a distribution agreement was invoked so as to prevent further sales. For licenses not covered by a block exemption but exempt under Article 81(1) EC, the same would presumably apply.

On the other hand, it is apparent that the notion of exhaustion and its doctrinal foundation as a matter of market freedom remains pertinent, but the extent to which it affects licenses is now debatable. This is because its doctrinal status is unclear. There are principally two positions taken up in approaching this debate. First, one may take the view that the principle of free movement of goods is still intact, and,

130. Commission Decision 95/373, *supra* note 102; *see* Joined Cases 55 & 57/80, Musik-Vertrieb Membran GmbH v. GEMA, 1981 E.C.R. 147 (suggesting that the ability to exploit was a precondition for exhaustion); *see also* Case T-504/93, Tiercé Ladbroke v. Comm'n, 1997 E.C.R. II-923.

therefore, the scope of licenses and their ability to bind third parties is irrelevant. This first view is based upon earlier jurisprudence, but presumes that a European exhaustion rule truly exists as a matter of intellectual property law. This position will be analyzed and ultimately rejected in Part III. The second view is to identify parameters to restrict the exercise of intellectual property rights, rather than as a matter of overcoming territorial restrictions. As will be discussed, this causes a number of problems due to the differences among national intellectual property laws in regard to the more delicate issues of divisibility of economic rights and the character of licenses as being proprietary.[131]

III. THE MYTH OF EUROPEAN EXHAUSTION: THE DOCTRINAL STATUS OF ARTICLE 30 EC IN COMPETITION LAW

In permitting territorial restraints as a matter of European Community competition law, the question, thus, arises as to the underlying rationale and continued applicability and potential of the exhaustion principle. The central issue is whether the exhaustion rule has binding effect in that, on the basis of the overriding free movement of goods principle, it eradicates restrictions in licensing agreements that permit some territorial protection. One way to address the issue is to consider the status of the exhaustion rule as part of national intellectual property laws implemented as a consequence of European Community legislation; here, in particular, the arguments may be raised in relation to exhaustion with respect to cases of online uses.

Currently, the statutory regulation of distribution systems of protected articles is tripartite. Regulation of distribution systems is permissible under the relevant block exemptions, but the question has arisen as to whether the VRR and TTR deal with exhaustion in different ways. Such an approach should be rejected because it would result in a divergent treatment of the exhaustion principle and would cause legal uncertainty. It is submitted, therefore, that the correct view is to treat the exhaustion question, not as an issue exclusively resolved under the provisions of the TTR, but as a more fundamental issue of proportionality. The correct interpretation of Article 2(1)(14) of the 1996 TTR and its successor, therefore, is that it merely deals with the validity of a contractual restriction rather than conferring powers on the basis of national intellectual property rights. This perception, as such, permits a more functional approach to the relationship between

131. *See infra* Part IV.A.

competition law and market freedom, and it need not be restricted to territorial restraints.

Thus, the issue of exhaustion turns in to the issue of the binding effect of that jurisprudence on national intellectual property rights. Here, the second and third regulatory layers need to be analyzed. This pertains to the dogmatic status of the exhaustion rule under Article 30 EC, which leads to the more general issue of the interface of competition rules and the free movement of goods.

A. Construction of Intellectual Property Under Article 30 EC: A Matter of Intellectual Property Regulation?

There is ample evidence to suggest that the interpretation of the principle of the free movement of goods, as applied to the exercise of intellectual property rights, is not concerned with a proprietary notion but is exclusively informed by the need to reconcile the conflict between territoriality and market freedom.

Under a more functional approach, the argument that exhaustion cannot occur within the context of Articles 28 through 30 EC may be based on the view that both provisions on competition control and the free movement of goods are complementary in the sense that both sets of rules exist to achieve the goal of a common market, as set forth in Article 2 EC.[132] Article 30 EC then primarily serves as a collision clause applied flexibly.[133] This view develops from the cumulation theory, as applied with respect to the interface between competition and market freedom rules. Accordingly, contractual territorial restrictions violate Article 28 EC only insofar as they constitute a discriminatory restriction.[134]

In that sense, Article 30 EC establishes a general collision clause between a justifiable and a non-justifiable exercise of intellectual property rights. Thus, the exhaustion rule is merely an instrument to achieve a result that would otherwise provoke a separation of the

132. *See Deutsche Grammophon*, 1971 E.C.R. 487; Case 24/67, Parke, Davis & Co. v. Probel, 1968 E.C.R. 55; Joined Cases 56 & 58/64, Etablissements Consten, S.A.R.L. v. Comm'n, 1966 E.C.R. 299. Some commentators have suggested that permitted licensing clauses under Article 81(3) EC should not additionally be subjected to Articles 28 through 30 EC. *See* LAURENCE W. GORMLEY, PROHIBITING RESTRICTIONS ON TRADE WITHIN THE EEC 20–21, 285 (1985); Martin Schödermeier, *Die Ernte der "Maissaaat": Einige Anmerkungen zum Verhältnis von Art. 30 und 85 EWG-Vertrag*, 1987 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT INTERNATIONALER [GRUR INT.] 85.

133. *See* EC Treaty art. 30.

134. *See id.* art. 28.

internal market. It can be used to overcome the fact that the EC Treaty does not affect the property rights guaranteed by the national legislation of Member States.[135] In that sense, it provides a line of argument based on a comparison between national laws and serves as a watershed by invoking the specific subject matter test, a test primarily used to overcome the intricacies of the territoriality principle in relation to the grant of a patent. This view is, for instance, supported by the rhetoric that the ECJ used in trademark cases. In cases concerning the repackaging of goods protected by trademarks, the ECJ has emphasized the potentially pro-competitive effects of prohibitions on resales because the act of repackaging conflicts with the original function of a trademark.[136] The ECJ, thereby, refers to the function of intellectual property rights in specific circumstances, which allows the trademark owner to oppose parallel imports.[137] In the context of its Article 30 EC analysis, the ECJ has established reasons for a justification of prohibitions on parallel imports and, thus, deviates from its own exhaustion jurisprudence.

The resulting jurisprudence created a need for a line of argument to allow for sound statutory interpretation and to lend doctrinal credibility to the existing reasoning promulgating the principle of free movement of goods. Article 30 EC expressly provides a justification on the basis of safeguarding national industrial property rights.[138] The exhaustion

135. *Id.* art. 222.

136. In relation to trademarks, the ECJ has developed the concept of the essential function, which subsequently found its way into the Trade Mark Regulation. *See* Case C-273/00, Sieckmann v. Deutsches Patent, 2002 E.C.R. I-11737 (stating that "the essential function of a trade mark is to guarantee the identity of the origin of the marked product or service to the consumer or end-user by enabling him . . . to distinguish that product or service from others"). Article 7 of the Trade Marks Approximation Directive establishes the principle of "exhaustion of the rights conferred by a trade mark." Council Directive 89/104, art. 7, 1989 O.J. (L 40) 1.

> 1. The trade mark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the proprietor or with his consent.
>
> 2. Paragraph 1 shall not apply where there exist legitimate reasons for the proprietor to oppose further commercialization of the goods, especially where the condition of the goods is changed or impaired after they have been put on the market.

Id.

137. Franz Christof Urlesberger, *"Legitimate Reasons" for the Proprietor of a Trade Mark Registered in the EU to Oppose Further Dealings in the Goods After They Have Been Put on the Market for the First Time*, 36 COMMON MKT. L. REV. 1195 (1999).

138. EC Treaty art. 30.

principle, as established in national laws related to distribution rights, provided a welcome device to inform the analysis as it existed in most Member States, and, in turn, it allowed for judicature based upon a comparative analysis of intellectual property laws combined with the aim of abolishing national boundaries. This was first based upon the existence and exercise dichotomy and later on the specific subject matter test. Both tests were necessary as normative elements under Article 30 EC. It also enabled the ECJ to overcome arguments purporting a cumulative application of the rules on restrictive practices contravening Article 81 EC and the rules on the free movement of goods.[139]

Under the cumulation theory, the ECJ would have had to prove a disguised restriction or discrimination, largely enabling parallel imports. National intellectual property rights can be exercised without such consequences under Article 81 EC,[140] and it would have forced the ECJ to rely upon the more restrictive provisions of Article 81 EC.[141] Hence, the exhaustion rule, as applied in the context of Article 30 EC, is one—albeit decisive—element in the balancing of interests analysis, but it is not a jurisprudential limitation on property rights as such. The subsequent formulation of a specific subject matter test serves as a device to channel the legal rhetoric into a sound and flexible balancing of interests. This approach reveals the dogmatic function of Article 30 EC as a collision clause when applied to conflicts between territorial intellectual property rights and market freedom. This test was informed by the almost unanimous will to give preference to market freedom, which is clearly evident in decisions focusing on actual—and later, hypothetical—reward and the subsequent reliance upon the sheer act of placing goods in the market. These arguments, albeit clad in a rhetoric pertaining to the subject matter of an intellectual property right, primarily reflect policy driven arguments and explain the shift toward emphasizing the consent issue as a decisive element for limiting the exercise of distribution rights.

It follows that the status of intellectual property exhaustion is undecided in regard to permissible restrictions. Thereby, the influence of Article 30 EC on national intellectual property rights appears extremely limited. The inference of a Community-wide exhaustion

139. *See* Case 15/74, Centrafarm BV v. Sterling Drug Inc., 1974 E.C.R. 1147.

140. F.A. Mann, *Industrial Property and the E.E.C.Treaty*, 24 INT'L & COMP. L.Q. 31, 34 (1975).

141. *See* GORMLEY, *supra* note 132, at 233; Beier, *supra* note 13.

"principle" is workable as long as it can be dovetailed with a general perception that the exercise of intellectual property rights as a means to redraw national boundaries is inconsistent with the common market aim; further, it should apply only to the extent that rules regarding restrictive licensing clauses are perceived as cumulatively violating the competition and free movement of goods provisions.[142]

B. Implemented European Intellectual Property Regulation: The Applicability of Article 28 EC and Permissible Restraints

Secondary legislation in Europe has been heavily influenced by the jurisprudence on exhaustion, and this has certainly led to an understanding of the exhaustion rule as a core principle of harmonized intellectual property law. In the case of implemented exhaustion rules, Member States are required to interpret such norms in accordance with European Community legislation. One interpretation is that a transposed exhaustion rule has enshrined the European first sale doctrine as a proprietary limitation on the distribution right. Such a reading has the effect of suggesting that exhaustion occurs, not as a matter of the overriding principle of free movement of goods, but as a limitation of national rights. Permissible restrictions would be a matter of competition law only, and their effect would certainly not be absolute so as to enable further control over subsequent market levels.

However, a closer look at national systems reveals that such an interpretation is unsound. Although it is clear that exhaustion occurs at the point where goods reach the consumer market, national laws still have discrepancies in relation to the scope of control and the question of whether such control can bind third parties.[143] This problem has never been addressed precisely because the European Commission relies upon a seemingly rigid manifestation of the traditional ECJ jurisprudence. The effect is that (1) restrictions that allow such control necessarily go beyond the scope of the limited intellectual property; (2) such clauses prima facie violate competition law and may only be exceptionally exempt; and (3) regardless of the permissibility of the clause, the free movement principle will supersede—that is, there is no allowance for a

142. This is because a violation of Article 81 EC would, according to the jurisprudence of the ECJ, simultaneously violate Article 28 EC. Joined Cases 56 & 58/64, Etablissements Consten, S.A.R.L. v. Comm'n, 1966 E.C.R. 299. The ECJ held that Article 30 EC cannot restrict the application of Article 81 EC. *Id.* Subsequently, the ECJ emphasized that Article 30 EC was applicable by way of analogy, but it referred to the occurrence of exhaustion. *See* Case 24/67, Parke, Davis & Co. v. Probel, 1968 E.C.R. 55, 61.

143. *See infra* Part IV.

cumulative and dovetailed application of both sets of rules. In short, arguments based on a dynamic balancing of interests are foreclosed.

One revelation of this position is that it consistently equates acts of distribution with physical goods. The questionability of this position becomes apparent in a different context: the relationship of the free movement of goods and the free provision of services. The main issue regarding the exhaustion principle is whether the jurisprudence, beyond the treatment of the territoriality aspects, can be interpreted at all to evoke an understanding of efforts to harmonize intellectual property rights. This issue has arisen with respect to the scope of exhaustion in relation to certain online uses. The European Commission has referred to the jurisprudence under Article 28 EC and concluded that, because online services do not constitutes goods but rather services,[144] exhaustion cannot occur.[145] The distinction between goods and services used to justify this conclusion remains unclear; simply, European economies experience an increasing overlap between the second and third sector. The ECJ showed clearly that mutual exclusivity was not warranted, but it was prepared to test a violation against both fundamental principles in a case concerning television advertisements targeted at children.[146] In short, the ECJ applied a discreet proportionality test.[147] In conclusion, very little of the ECJ's judicature allows for an argument based upon the exclusion of exhaustion. Practically, this may allow for an enlarged scope for national laws to invoke the exhaustion principle, but it certainly casts doubt upon the availability of invoking a general exhaustion rule under Article 28 EC.

The reason for this exclusion is threefold. The first is closely intertwined with the structure of Article 49 EC and the preceding provisions dealing with the freedom to provide services as compared to Article 28 EC. Article 49 EC does not contain a provision allowing for

144. This notion may also be inferred from the Directive on Electronic Commerce, which refers to services as a matter of regulating online services. *See* Council Directive 2000/31, 2000 O.J. (L 178) 1.

145. *Id.*

146. Joined Cases C-34, 35 & 36/95, Konsumentombudsmannen v. De Agostini (Svenska) Förlag AB, 1997 E.C.R. I-3843. The goods to be marketed were collectable parts for a children's reference book on dinosaurs produced by an Italian manufacturer. The advertisements were broadcast from the United Kingdom into, inter alia, Sweden, where media law prohibits advertisements targeted at children. Although the impact of the prohibition was assessed in relation to both fundamental principles, the justification of the Swedish media law provision was not addressed apart from the provisions of Articles 28 through 30 EC and Article 49 EC. *See id.*

147. *See supra* note 146.

a justification.[148] Compared to Article 30 EC, the missing link is that the escape route toward a proportionality test is absent.[149] This means that the absence of an applicable exhaustion rule as an element allowing the ECJ to strike a balance—or indeed to invoke other principles, which may operate to restrict national intellectual property rights—is not open.[150] Even if the systematic escape route under Article 30 EC is obstructed because Article 28 EC does not apply, the ECJ has already clarified that the freedom to provide services does not apply without any restriction.[151] Rather, it has upheld that national restrictions, which are proportional, can justify a derogation from Article 49 EC, which, in truth, reveals an application of a proportionality test by way of analogy to Article 30 EC. Expressly, these include the protection of intellectual property.[152] Hence, based on current judicature, one may assert that Article 49 EC may, indeed, be limited by the application of inherent intellectual property restrictions, which might as well include the application of the exhaustion rule under national law; importantly, this conclusion casts doubt upon the viability of a rigid exhaustion rule in cases concerning permissible restraints. Secondly, with respect to copyright law, the European Commission has relied upon the decision in *Coditel v. Ciné Vog Films*[153] concerning a very specific issue in relation to public performance rights, which is ultimately unhelpful for purposes of arguing in favor of an overall exclusion in relation to a vague notion of online services. And thirdly, to the extent that the European Commission relies upon the definition of "online services" outlined in the Directive on Electronic Commerce, it disregards the fact that, again, the definition of "services" functions so as to focus the restrictions for typical Internet services across the board, rather than serving as a role model for categorizing exclusive rights and their limitations in copyright.[154]

The division between goods and services under the EC Treaty, therefore, gives no guidance as to the extent to which intellectual

148. *See* EC Treaty arts. 28, 49.

149. *See* Herman Cohen Jehoram & Kamiel Mortelmans, *Zur "Magill"—Entscheidung des Europäischen Gerichtshofs*, 1997 GRUR INT. 11, 14.

150. *Konsumentombudsmannen*, 1997 E.C.R. I-3843.

151. *Id.*; *see also* EC Treaty art. 30.

152. *See* Case C-384/93, Alpine Invs. BV v. Minister van Financien, 1995 E.C.R. I-1141; Case C-288/89, Stichting Collectieve Antennevoorziening Gouda v. Commissariaat voor de Media, 1991 E.C.R. I-4007, para. 11; Case C-76/90, Säger v. Dennemeyer & Co., 1991 E.C.R. I-4221.

153. Case 62/79, Coditel v. Ciné Vog Films (*Coditel I*), 1980 E.C.R. 881.

154. *See* Council Directive 2000/31, *supra* note 144.

property rights can be exercised or limited as a matter of national law. As far as the scope of the exhaustion rule in relation to online services is concerned, the negation of exhaustion merely follows from the fact that a limitation based upon exhaustion could not be argued because the classification as service systematically forecloses that line of reasoning. This shows that the regulatory scope of fundamental freedoms and the acceptable scope of national intellectual property rights are not identical. It remains an issue of proportionality. By applying this more accommodating proportionality assessment, the ECJ recognizes the increasing convergence of industrial sectors and the need to restructure the normative provisions under primary European Community laws.[155] The jurisprudence does not articulate any terminology that can be understood as autonomously defining the scope of intellectual property rights. Hence, inasmuch as the interpretation of Article 30 EC is subject to an assessment of proportionality, any interpretation of national norms implementing the European exhaustion rule on that basis results in circular argumentation.

It necessarily follows that the traditional judicature regarding Article 30 EC, likewise, does not permit an inference in relation to an understanding of a proprietary exhaustion rule above and beyond the final act of putting an article on the consumer market.

IV. THE EFFECTS OF HARMONIZING TERRITORIAL RESTRAINTS: THE BLIND SPOTS

The scope of permissible control can neither safely be deduced from the rule on the free movement of goods, nor can it be immediately inferred from competition law. What is clear is that exhaustion will occur once an article is placed on the consumer market;[156] yet, the interface between exhaustion and permissible restraints remains dubious as far as restrictions vis-à-vis commercial licenses are concerned.

Dogmatically, therefore, territorial and other restrictions permitting exclusivity, which are necessary to maintain the function of an intellectual property right, supersede the exhaustion principle as long as it is accepted that Articles 28 through 30 EC are adaptable to the

155. This is obvious in cases where a clear distinction between goods and services is not possible because the effect of marketing products potentially falls—directly or indirectly—within both Articles 28 and 49 EC. *See* EC Treaty arts. 28, 49.

156. This follows simultaneously from the inapplicability of the TTR and VRR to contracts relating to end consumers and the general exhaustion doctrine limiting intellectual property rights as implemented in national laws.

current levels of European market integration. The higher the level of integration becomes, the less it is necessary to rely on rules aimed at safeguarding free circulation; at higher levels of integration, the common market approaches a virtual free trade similar to, for instance, the United States.[157]

A. Partial Inapplicability of Article 30 EC?

To the extent that competition law, including the European Commission's practices,[158] is becoming more lenient, the effect of exhaustion and, consequently, the concept of divisibility of control rights cannot be answered under Article 30 EC; this is, among other reasons, because certain restrictions are deemed as pro-competitive and, thereby, shift the scales toward the right owner's interests. The effect of competition rules in excess of core regulatory functions in exempting certain pro-competitive restraints is an exclusionary effect upon the additional application of Articles 28 and 30 EC—this is, of course, unless the position is taken that the rule on exhaustion, as a matter of the free movement of goods, has resulted in a proprietary limitation of national intellectual property rights or that the implementation of the exhaustion rule is subject to an identical statutory interpretation in all Member States.

According to this view, exhaustion occurs as a consequence of licensing,[159] delimiting the potentially more generous scope under national law and denoting that third parties cannot be bound by permissible restraints.[160] But, as outlined previously, not only is such a position not credible from a doctrinal point of view;[161] but it also ignores the transformed approach in regard to the territoriality issue and forecloses any flexibility for adapting pro-competitive effects to an increased level of market integration. This view aligns with similar views taken regarding the concept of the cumulative application under

157. The U.S. Patent Act permits territorial restrictions even as applied to a common national market, but it does curtail the patent owner's control after the first sale to the consumer. *See* 35 U.S.C. § 261 (2000). This solution amounts to a significant step away from the reward notion. The licensor would be able to control the distribution up to the point when the article is physically in the hands of the consumer.

158. Commission Decision 95/373, *supra* note 102.

159. This is the case both as a matter of European Community law, *see, e.g.*, Case 19/84, Pharmon BV v. Hoechst AG, 1985 E.C.R. 2281, and simultaneously domestic law.

160. More precisely, attempts of a licensor to employ divisible statutory intellectual property rights in order to divide the market and limit the effects of exhaustion violate the free movement of goods principle.

161. *See supra* Part III.A.

the Patent Licensing Block Exemption, suggesting a corresponding application of the competition and free movement of goods principle that a permissible restriction should not simultaneously be subject to additional constraints as a matter of market freedom.[162] Such a position seeks to overcome the problem of the traditional exhaustion concept by rendering national intellectual property rights applicable unless discriminatory or abusive conduct results. Article 30 EC was perceived as inapplicable to sheer limitations arising out of permissible restraints. What is crucial in this context is that such an approach had to operate against the extremely severe interpretation that, by then, unswervingly favored the free movement of goods principle[163] and resulted in the European license doctrine. An open exclusive licensing agreement containing permissible clauses, thus, remained unenforceable because those clauses contravened Article 28 EC. The effect was to curtail a patentee's right as a matter of fostering market integration,[164] but by then the jurisprudence on Article 30 EC was in line with both the more restrictive provisions on patent licensing[165] and the accepted perception that exhaustion was inextricably coupled with the act of licensing.[166]

The question now emerges in a different regulatory context to the extent that the TTR permits control over subsequent sales even in closed licenses allowing absolute territorial protection.[167] If a licensor is allowed to reserve territories, the application of Article 30 EC in order to advertently constrain such control would preempt pro-competitive effects because the licensor would be restricted to seeking contractual redress against his or her licensee. If, therefore, the TTR and, presumably, Article 81(1) EC[168] exempt territorial restrictions by

162. *See* Oliver Axster, *Offene Fragen unter der EG-Gruppenfreistellungsverordnung für Patentlizenzverträge*, 1982 GRUR INT. 581. Hence, if the clause in question is enforceable under national intellectual property laws and does not violate the provisions on anti-competitive agreements, exhaustion does not occur as a matter of European Community law, although it may occur as a matter of national law. *See also* Valentine Korah, *The Limitation of Copyright and Patents by the Rules for the Free Movement of Goods in the European Common Market*, 14 CASE W. RES. J. INT'L L. 7 (1982).

163. Venit, *supra* note 110, at 517.

164. This effect, though, has a certain degree of inconsistency. *See* GORMLEY, *supra* note 132, at 233; Schödermeier, *supra* note 132.

165. Commission Regulation 2349/84, *supra* note 49, art. 1 (applying to open exclusive and nonexclusive licenses only); *see* Dieter Hoffmann & Orlagh O'Farrell, *The "Open Exclusive License"—Scope and Consequences*, 6 EUR. INTELL. PROP. REV. 104, 108 (1984).

166. Case 187/80, Merck & Co. v. Stephar BV, 1981 E.C.R. 2063.

167. *See* Case 27/87, Erauw-Jacquéry v. La Hesibignonne, 1988 E.C.R. 1919; Case 262/81, Coditel v. Ciné Vog Films (*Coditel II*), 1982 E.C.R. 3381.

168. In the TTR Guidelines, the Commission asserts that it will apply the same

allowing some degree of proprietary control arising out of statutory rights,[169] then this would denote a shift toward a greater recognition of intellectual property rights and a partial withdrawal of the free circulation argument since the permissible exercise on the basis of harmonized law cannot be discriminatory.

Moreover, an additional question arises: whether Article 28 EC can apply at all. If territorial restrictions, as a matter of national intellectual property laws, are deemed pro-competitive,[170] then there is no prospect for additionally being able to invoke Article 30 EC because it may be argued that a permissible restraint on the basis of European Community law cannot simultaneously constitute a measure having equivalent effect; it applies irrespective of possible discrepancies in national laws, whether or not such restrictions go beyond the national intellectual property rights, because all intellectual property systems are treated equally. It may also be suggested that if Article 28 EC applies only with respect to territorial discrepancies, then the exercise of a permissible right is not an obstacle to the free movement of goods.

Consequently, there is no capacity for applying a proportionality test under Article 30 EC because dogmatically the permissibility of territorial restrictions is resolved under secondary legislation that takes precedence insofar as it regulates the issues in question, and a restraining clause is not a result of divergences in the scope of national intellectual property rights because the rights are still granted as a bundle of national and, thus, territorial rights. The question of exhaustion under Article 30 EC, therefore, cannot arise; it can only arise once national discrepancies in the concrete application of national intellectual property laws distort the concept of free movement of goods. Consequentially, the additional applicability of Article 30 EC will depend upon the scope given to a permissible territorial restriction under the block exemptions, and the greater the scope is as a matter of judicial interpretation, the higher the harmonizing effect will be. An interpretation that permits the owner control until the very act of putting the article on the market will, therefore, foreclose the application of Article 30 EC because it harmonizes the scope of national intellectual property rights to a significant degree. A more constrained

principles to other intellectual property categories as to those expressly covered. TTR Guidelines, *supra* note 41, at 10.

169. Commission Decision 95/373, *supra* note 102.

170. *See* Hugh C. Hansen, *International Exhaustion*: *An Economic and Non-Economic Policy Analysis*, 6 INT'L INTELL. PROP. L. & POL'Y 114-1, 114-9 to -10 (2001).

view will engender an expanded scope for national perceptions that, if divergent, will resurrect the free movement of goods issues.

It follows that, in the sphere of such partial harmonization of licensing rules, the avenue taken toward a balancing of interests is not open because Article 28 EC, as a prerequisite, refers to discrepancies between national laws that have "equivalent effect," but such effect is necessarily absent if the rules on restrictive licenses are harmonized within the scope of the TTR or VRR.[171] Therefore, in relation to the doctrinal foundation of the exhaustion principle as an element of Article 30 EC, the question of exhaustion cannot arise. Therefore, the provisions on the free movement of goods cannot be applied to limit the permissible exercise of intellectual property rights under competition law.

What can be asserted is that at least some modest level of harmonization exists, and good reasons can be put forward to preclude the application of Article 30 EC both as a matter of dogmatic consistency and for substantive reasons to not revert back to indiscriminate restrictions on grounds of the free circulation of goods. The reality, though, is that no true harmonization has been achieved with respect to the divisibility of the exploitation rights and the subsequent effects this has on notions of national exhaustion.

B. Territorial Restraints and National Exhaustion Rules

The concept of territorial restraints under competition law shows a remarkable lack of harmonizing power because it leaves a number of blind spots. If it permits territorial restrictions as a matter of exercising national intellectual property rights, it excludes the applicability of Article 28 EC to the extent that Member States employ identical concepts of national exhaustion, matching rules with respect to the effect of territorial restrictions in terms of absolute (proprietary) or relative (contractual) protection.[172] As will be demonstrated in the discussion that follows, this is not the case.

National systems may employ different notions of national exhaustion, particularly in regard to differentiations at varying market levels. The ambiguity of block exemptions as to the effect of permissible restraints on exhaustion also triggers a number of blind spots. Dogmatically, the exclusion of the proportionality test, under

171. *See* EC Treaty art. 28; *see also* 2004 TTR, *supra* note 24; VRR, *supra* note 25.

172. Such a level of harmonization can be achieved if the scope of permissible restraints is incorporated into statutory intellectual property laws.

which the exhaustion principle has developed, implies that Articles 28 through 30 EC cannot be invoked in relation to overriding public interests safeguarding the free circulation of goods.[173] The problem will have to shift to national law or be reintroduced under a different heading, such as consumer protection. In turn, the admissibility of territorial restraints largely depends on national notions of the scope of licenses.

Under various national laws, the discrepancies are striking and the correct legal position is often blurred. National laws normally do not permit territorial restraints, but complex licensing agreements may involve a division of product markets. Regarding the divisibility of rights,[174] German copyright law, for example, permits the division of distribution rights insofar as distinct product markets are concerned.[175] This follows from Article 31(4) of the German Copyright Act, which generally preserves the right of an author to grant mutually exclusive licenses in relation to separate product markets.[176] However, territorial restraints within the jurisdiction are not permissible.[177] The effect of a contractual restraint upon exhaustion remains dubious, and the extent to which it can bind a bona fide third-party purchaser is debatable. In the *OEM-Software* decision, the German Federal Court of Justice, Bundesgerichtshof (BGH), rejected any effect of an express limitation on the occurrence of exhaustion.[178] The court held that imposing an obligation on a wholesaler to sell certain types of software only when attached to hardware was unenforceable because exhaustion had occurred at the time when the software was issued to the wholesaler.[179] The court did not refer to the scope of the contractual limitations, as such, but it did point to the effects upon consumer protection, suggesting that copies issued without consent would be exhausted as a matter of a limitation on proprietary rights, even before the copy had reached the end consumer.[180]

173. *See* EC Treaty arts. 28, 30.

174. SAM RICKETSON, THE BERNE CONVENTION FOR THE PROTECTION OF LITERARY AND ARTISTIC WORKS: 1886–1986 400 (1987).

175. *See* Urheberrechtsgesetz [UrhG] [Authors Rights Act], Sept. 9, 1965, BGBl. 1 at 1273, art. 31(4) (F.R.G.).

176. *Id.*

177. *See* GERHARD SCHRICKER, URHEBERRECHT: KOMMENTAR § 17 (2d ed. 1999).

178. Bundesgerichtshof [BGH] [Federal Court of Justice], June 7, 2000, I ZR 244/97 (F.R.G.), *available at* http://www.jurpc.de/rechtspr/20000220.htm.

179. *Id.*

180. *Id.*

In the United Kingdom, the exact circumstances for the occurrence of exhaustion are debated in a similar way.[181] The exhaustion principle was introduced into the intellectual property laws of the United Kingdom only as a consequence of European harmonization. The traditional view was that a right holder enjoyed an unlimited right to control distribution channels,[182] and intellectual property rights were perceived to be divisible in this regard.[183] Under the laws of the United Kingdom, the principal issue for exhaustion is identifying the relevant stage in a distribution chain in which exhaustion will occur.[184] The general view is that it should do so before the goods reach the consumer market, although this rationale has been explained with reference to preventing secondary liability for consumers.[185] Section 18(2) of the Copyright, Designs and Patents Act, for instance, refers to subsequent acts of distribution with respect to copyrighted works.[186] It is clear that copies issued without consent will infringe, and a license must be present.[187] The case law, however, varies with regard to the divisibility of rights and the proprietary effects in cases where consent is limited to certain product or territorial markets.[188] In analyzing this matter, some commentators prefer the "destination theory"[189] while others advocate for the "disposition theory."[190] In France and Belgium, a copyright owner is able to bind third-party purchasers beyond the first market level on the basis of a general destination right—*droit de destination*.[191] In the United States, territorial restrictions are generally perceived as

181. John Phillips & Lionel Bentley, *Copyright Issues: The Mysteries of Section 18*, 21 EUR. INTELL. PROP. REV. 133, 137–38 (1999).

182. *See* Beecham Group Ltd. v. Int'l Prods. Ltd., [1968] R.P.C. 129, 135–36 (Kenya) (extending the right to putting articles on the market abroad); Dunlop Rubber Co. v. Longlife Battery Depot, [1958] R.P.C. 473, 476 (U.K.).

183. *See* sources cited *supra* note 182.

184. Phillips & Bentley, *supra* note 181, 137–38.

185. *Id.*

186. Copyright, Designs and Patents Act, 1988, c. 48, § 18(2) (Eng.).

187. *Id.*

188. Nelson v. Rye, [1996] F.S.R. 313 (U.K.) (suggesting that exhaustion does not occur between a manufacturer and a trader); *see also* Football Ass'n Premier League Ltd. v. Panini UK Ltd., [2003] EWCA (Civ) 995 (Eng.).

189. HUGH LADDIE ET AL., THE MODERN LAW OF COPYRIGHT 387–90 (1980).

190. *See* Infabrics Ltd. v. Jaytex Ltd., [1982] A.C. 1 (regarding secondary infringement rules under the copyright laws of the United Kingdom); *see also* Copyright, Designs and Patents Act §§ 22–26.

191. *See* FR. S. DEB. 317 (Apr. 28, 1999) (statement of Sen. Danièle Pourtaud), *available at* http://cubitus.senat.fr/rap/198-317/198-3170.html; *see also* Axel Metzger, *Erschöpfung des urheberrechtlichen Verbreitungsrechts bei vertikalen Vertriebsbindungen*, 2001 GEWERBLICHER RECHTSSCHUTZ UND URHEBERRECHT [GRUR] 210.

pro-competitive,[192] but antitrust law does not allow restrictions beyond the first sale of a patented article.[193]

These rather divergent approaches result in blind spots. Blind spots in relation to "pure" territorial restrictions concern the scope of control over market levels—that is, the occurrence of exhaustion as a matter of national law. The respective exhaustion rules established in secondary intellectual property legislation do not deal with contractual divisibility, nor do the block exemptions. This reintroduces the issues of free circulation addressed under Article 28 EC, albeit under a different heading. If the first act of licensing does not exhaust the right, it becomes a matter of national law to define the scope of intellectual property licensing to permit the owner control over subsequent acts of distribution. Therefore, a restriction, territorial or otherwise, in a cross-border licensing contract remains subject to Article 28 EC provided that it constitutes a measure having equivalent effect. This will be the case if such a restriction constitutes an indirect restriction, which will normally be the case if the national intellectual property laws of the countries in question are divergent on the scope and effect of such a restriction.

As far as territorial restrictions are concerned, the effect of non-exhaustion following the first act of licensing needs to be reconciled with the criteria applicable under Article 81(1) EC.[194] It is clear that the last act of distribution will exhaust the right,[195] but there is tremendous ambiguity as to the exercise of statutory rights before that point; the traditional jurisprudence on European exhaustion is unhelpful to the extent that the rules on territorial restrictions have been relaxed. In

192. United States v. Arnold, Schwinn & Co., 388 U.S. 365 (1967) (finding a territorial distribution illegal under § 1 of the Sherman Act because it harmed competition among distributors). The Court's decision in *United States v. Arnold, Schwinn & Co.* sparked controversy that, in turn, generated a considerable amount of scholarly work focusing on the economic effects of vertical arrangements. Ultimately, territorial restraints could be used to address the "free-rider phenomenon." *See also* Cont'l T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977) (concluding that a per se illegal approach to territorial restraints was fallacious). The Court pointed out that vertical restraints should be evaluated under the rule of reason. *Id.* The lawfulness of a particular vertical restraint depends upon whether the restraint, on balance, restricts or promotes competition. *See* Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679 (1978) (interpreting 35 U.S.C. § 261 to allow territorial divisibility of patent distribution licenses to the whole or any specified part of the United States).

193. United States v. Univis Lens Co., 316 U.S. 241 (1942); Adams v. Burke, 84 U.S. (17 Wall.) 453 (1873). Therefore, if a territorial restriction in a license purports to control conduct beyond the first sale, the license would not be protected from antitrust scrutiny under § 261 of the U.S. Patent Act. *See* 35 U.S.C. § 261 (2000).

194. *See* EC Treaty art. 81(1).

195. This is true both as a matter of European Community law and as a consequence of implemented directives concerning the exhaustion rule.

relation to whether such a restriction may be exempt from Article 81(1) EC, different criteria will apply. It is an issue of balancing pro-competitive effects of, for instance, restrictions placed upon product markets, such as preventing free riding, with more general concerns, such as free circulation of goods. The effect is that, due to the inapplicability of Article 30 EC, inferences have to be derived from the arsenal of national laws. Conversely, if Articles 28 and 30 EC are deemed applicable, then the question is one of national divergences regarding the scope of divisibility of exploitation rights, which then needs to be justified under Article 30 EC. However, as a matter of the free movement of goods principle, it is unclear what parameters can be taken into account. This will induce either a preference for the strictest[196] or the most lenient national system.[197]

C. Non-Territorial Restraints and European Exhaustion

If block exemptions permit a rights holder to oppose reimports on the strength of divided intellectual property exploitation rights devoid of the exhaustion effect, then the related issue emerges of whether license clauses restricting the product market can be enforced. Restrictions imposed upon the product market in which a protected article may be sold under the stipulations of a licensing agreement are common. A licensor has an economic interest in being able to separate product markets. Such separation is permissive under national laws as long as it does not contravene domestic competition law and go beyond the scope of the national intellectual property right granted by statute.

The TTR apparently permits such restrictions provided that the market share thresholds are not exceeded; however, there is no guidance or case law to support this.[198] Even so, the TTR will only apply provided that the contract, at its core, pertains to more than a supply and distribution agreement,[199] which in most cases will not come to pass. The VRR allows such separation provided that the agreement pertains to ancillary intellectual property rights and falls outside the scope of

196. Such a result potentially arises from a lowest common denominator solution under a general free movement of goods solution.

197. According to the jurisprudence of the ECJ, the scope of intellectual property rights—in the absence of European harmonization—remains a matter of national law; therefore, an absolute general preference for the free movement of goods cannot be surmised. *See* Case 158/86, Warner Bros. v. Christiansen, 1988 E.C.R. 2605.

198. *See generally* 2004 TTR, *supra* note 24.

199. *Id.* recital (19).

Article 4.[200] But even if such a conclusion can be drawn, it is difficult to imagine a contract where the intellectual property right, itself, serves as a basis for different markets.[201]

The separability into different market segments does not result from the territorial nature of the intellectual property rights in the sense that the rights conferred are still a bundle of national property rights. The proprietary effect emanates from the substantive rules of national intellectual property laws and the extent to which those laws allow for separation into product markets. Likewise, agreements restricting the ability of licensees to sell in different product markets raise the issue of exhaustion. If the respective block exemptions permit this restriction, it remains doubtful whether such a clause has proprietary effect in that the distribution right has not been exhausted in cases where the articles have been sold into different product markets. This market partitioning has the same effect as territorial licenses in that it indirectly impacts upon the ability of licensees to sell into different markets in other territories of the European Community. This would then allow the application of Articles 28 and 30 EC, provided that the respective distribution rights have not been exhausted, and, at present, this is largely a problem of national law.

In Germany, for instance, restrictions on product markets are contractually enforceable vis-à-vis the licensee provided that, from a commercial standpoint, the markets defined in the agreement are distinguishable.[202] The question becomes one of whether further sales by third parties can be controlled by the rights owner on the strength of the distribution right. In the *OEM-Software* case, the BGH concluded that the exhaustion rule prevailed because the national distribution right under copyright law merely granted a right of putting the article on the market for the first time without addressing the effect of a proprietary restriction.[203] Such restrictions have prevailed under the laws of Germany and the United Kingdom, but in France and Belgium, the proprietary effect of a distribution license restricted to certain product markets allows functional control of the entire distribution chain.[204]

200. VRR, *supra* note 25, art. 4.

201. *See id.*

202. *See, e.g.*, Bundesgerichtshof [BGH] [Federal Court of Justice], Nov. 21, 1958, I ZR 98/57, 1959 GRUR 200, 202.

203. Bundesgerichtshof [BGH] [Federal Court of Justice], June 7, 2000, I ZR 244/97 (F.R.G.), *available at* http://www.jurpc.de/rechtspr/20000220.htm; *see* SCHRICKER, *supra* note 177.

204. *See, e.g.*, Law No. 92-597 of July 1, 1992, art. L. 122-6, Journal Officiel de la

Hence, the proprietary effect of the restriction is limited to the copyright owner's relationship with the first licensee or purchaser, but it cannot be invoked against any further sale.[205] The BGH, thus, favored market freedom over intellectual property rights.[206] That is, national exhaustion was deemed to have occurred as a matter of accomplishing a high level of free circulation. A restriction on product markets that is permissible under national law can have the effect of indirectly restricting reimports on a cross-border level, for instance, if the licensor licenses a manufacturer to sell copies of books only to be sold in book clubs. Here, the right is exercised, not as matter of an expressly permissible conduct, but as a consequence of the divisibility of the statutory right in national law. An attempt to keep out articles from the original territory amounts to a territorial restriction that is not exempt due to the nature of the contract. But the substantive rationale is the same—the division into separate product markets is a device to encourage intra-brand competition.

From an antitrust standpoint, the extent to which such clauses should be restricted is an issue of the pro-competitive effects. From a copyright standpoint, it is an issue of the scope of proprietary exploitation rights. If it is permissible as a matter of national law, the competition issue is conclusive because the exercise of divided statutory rights is within the scope of national laws. In relation to the free movement of goods, the situation is no different except for the fact that Article 30 EC can apply due to the effect of the statutory right allowing market divisions and operability as an obstacle to free trade. The issue of nondiscriminatory but divergent national rules on exploitation rights has already been resolved to the effect that it remains a matter of national law to define its scope.[207] A national rule permitting a more extensive interpretation vis-à-vis the divisibility of exploitation rights is functionally no different from the existence of more or less generous economic rights. The true issue is the ensuing conflict with the domestic exhaustion principle.

Under general rules of statutory interpretation, this would normally result in an obligation to construe such exhaustion rules in conformity

République Francaise [J.O.] [Official Gazette of France], July 3, 1992.

205. *See, e.g.*, *id.*

206. *See* sources cited *supra* note 203.

207. *See* Case 35/87, Thetford Corp. v. Fiamma, 1988 E.C.R. 3585 (permitting the U.K. relative novelty doctrine); Case 158/86, Warner Bros. v. Christiansen, 1988 E.C.R. 2605 (accepting nondiscriminatory divergences in relation to the specific Danish Lending Right); *see also* KORAH, *supra* note 28, at 300.

with models under secondary intellectual property legislation, but in relation to the issue here the legislation remains eerily silent. National courts must refer to the traditional notions and doctrinal framework of exhaustion or, alternatively, apply the customarily restrictive European exhaustion concept.

This is specifically problematic in relation to the fundamental divergences between the copyright and *droit d'auteur* systems. The proprietary scope of exploitation rights will be influenced by the respective copyright rationales, tending to allow a greater scope of control within author right systems given the stronger impact of personality rights. Conversely, in the *OEM-Software* case, for example, the BGH merely referred to the aim of "free circulation."[208] An absolute proprietary effect of divided rights was, thereby, avoided.[209] Operating within the framework of European law, this view is difficult to reconcile with the net pro-competitive effects of distribution agreements, but even on a national level, the prevailing effect of exhaustion will result in a tendency toward direct sales. The effect may well be to destroy separate levels in a distribution chain. Therefore, even if the block exemptions are inapplicable, such restriction may be exempt under Article 81(1) EC.[210]

CONCLUSION

The question of the interface between the principle of free movement of goods and the restrictive practices in intellectual property licenses must be assessed with renewed vigor. The block exemptions now permit territorial and other restraints without addressing the exhaustion issue per se. From an economic perspective, this permits inferences based on a pro-competitive rationale of restrictions on both territorial and product markets.

From a dogmatic standpoint, the problem pertains to the validity of clauses in licensing agreements that are, therefore, not voided as a matter of national contract law. It otherwise denotes that rules derived from secondary legislation are applied based upon the scope of national intellectual property rights, causing a particular problem of interpretation. Exhaustion might not occur in cases where secondary legislation expressly preserves a right to limit licensing territories, and it

208. *See supra* note 203 and accompanying text.

209. *See* sources cited *supra* note 203.

210. *See* A. Seffer & J. Beninca, *OEM-Klauseln unter dem Gesichtspunkt des europäischen Kartellrechts*, 2004 DER IT-RECHTS-BERATER [ITRB] 210, 213.

would not apply when the agreement in question is not primarily concerned with intellectual property licensing. Given the very delicate boundary between vertical restraints and technology transfers, such deduction would certainly lead to legal uncertainty.[211] The better view is to treat those provisions, as far as exhaustion is concerned, as neutral.

The question that remains concerns the impact of the principle of free movement of goods. In relation to exhaustion, the question is whether the notion of a European exhaustion rule—in the sense of a first sale doctrine—is viable, and, if so, why. There are two ways to address the issue. The first is to simply agree upon a general rationale to limit the exercise of intellectual property rights. This approach appears to be the predominant conclusion derived from the judicature on parallel imports, and it is supported by the existence of national rules encompassing the first sale doctrine as a consequence of European Community legislation in the intellectual property sphere. There are, however, a number of arguments that reveal that the general notion of a shared exhaustion rule—that is, the inference of judicature primarily concerned with limiting the absolute and proprietary scope of intellectual property rights—is, at the least, misleading. The promulgation of an overarching European exhaustion principle has been, if at all, a response to the dynamics of shaping a single market rather than an attempt to approximate intellectual property laws. "Exhaustion" has become a metaphor for a variety of approaches that sought to delineate permitted and improper exercises of intellectual property rights regarding the free movement of goods.

The dissenting views, on the other hand, are unpersuasive. The effect of national laws that are divergent regarding the scope of divisibility may be to create measures having equivalent effects in the sense that a more restrictive scope under national law may be exercised so as to prevent imports; some jurisdictions might allow a greater scope of control encompassing further market levels. But it is questionable whether Article 30 EC can address those problems. Although the disparities deemed as "measures having equivalent effect"[212] arise out of the territorial nature of national intellectual property rights, their continued applications are different as a result of the respective proprietary scope of licensing rights under national laws.

If, conversely, Article 30 EC were to be applied with respect to discrepancies arising from blind spots, which are not harmonized, the

211. *See supra* Part II.A.

212. EC Treaty art. 28.

effect would be a lowest common denominator solution based on the most austere national intellectual property system in order to artificially invoke the application of the exhaustion rule. Such an approach is potentially inconsistent with the more lenient treatment of restraints in licensing contracts. It would bar substantive arguments pertaining to the rationale of permitting restraints on both territorial and product markets.

The inadequacy of the current approach is that the very concept of Article 28 EC relies upon eliminating national discrepancies that constitute measures having equivalent effect.[213] Its application to intellectual property has evoked a far-reaching discernment as a general substantive rule, which, given the dynamics of integration, is neither conceivable nor desirable. Hence, the exhaustion principle is a line of argument that resulted from an initial distinction between existence and exercise and the related specific subject matter test. It may, thus, be ignored to the extent that national intellectual property rights are harmonized with respect to the scope of the national exhaustion rule, and such harmonization is partially achieved by permitting certain restraints.

213. *See id.*