Parallel trade

How to protect your brand

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Ian Kirby and **Tim Frazer** of **Arnold & Porter** consider how companies can protect their goods from parallel importers.

The practice of parallel importation is an issue for many multinational companies who sell their goods at varying prices depending on the country in which they are selling. Parallel importers exploit these price differences by buying the goods in a low priced country and reselling them in a higher priced country at a lower price. This can lead to prices being depressed in the higher priced territory.

One way companies may prevent parallel imports is by relying on their intellectual property rights (IPRs), in particular, trade mark rights. The European Court of Justice (ECJ) has recently held that brand owners can rely on trade mark rights to prevent the sale of parallel (or grey) imports from outside the European Economic Area (EEA) (the 15 EU member states together with Iceland, Norway and Liechtenstein) (*Joined cases C-414/99, C-415/99 and C-416/99, Zino Davidoff SA v A&G Imports; Levi Strauss & Co and Anor v Tesco Stores, Tesco plc and Costco Wholesale UK Ltd, 20th November, 2001; PLC, 2001, XII(11), 76*) (*Levi's v Tesco*).

This article examines the role of IPRs and EU competition law and policy in the regulation of parallel imports in Europe and the strategies that a trade mark or brand owner may use to combat parallel trade in his goods.

Repackaging of pharmaceutical products

Trade marked goods bought in one member state can be repackaged, relabelled or rebranded by parallel importers so that the same goods may be sold in a second member state in compliance with the second member state's laws and consumer preferences. This is often the case for pharmaceutical goods. The UK, being a high price pharmaceutical market, is often the destination market for repackaged parallel imports from other European Economic Area (EEA) countries.

As with other parallel imports, trade mark rights cannot be used in one member state to stop parallel imports from elsewhere in the EEA, provided that the parallel importer has repackaged the goods in a reasonable manner. The commercial significance of repackaging to pharmaceutical companies has resulted in a lot of litigation and analysis of what is reasonable repackaging, and what is the correct balance to be struck between the rights of the trade mark owner and the free movement of goods principle in Articles 28 and 30 of the EC Treaty.

The European Court of Justice guidelines for the repackaging, relabelling and re-affixing (or rebranding) of pharmaceutical products allow a trade mark owner to oppose repackaging unless:

- The opposition would contribute to the artificial partitioning of the internal market of the EEA.
- The repackaging would not adversely affect the original condition of the goods inside the packaging.
- The person who repackages the goods informs the trade mark owner of the repackaging before the repackaged goods are put on sale.
- The new packaging gives the details of the person who repackaged the goods.

(*Case 427/93 Bristol-Myers Squibb v Paranova ([1996] ECR I-3457; PLC, 1996, VII(9), 60); Affirmed by the opinion of Advocate General Jacobs, Case 443/99 Merck Sharp & Dohme GmbH v Paranova Pharmazeutika Handels GmbH and Case C 143/00 Boehringer Ingelheim KG & Others v Swingward Limited & Others 12th July, 2001; PLC, 2001, XII(9), 73*).

The guidelines, with only minor variations, have been treated as applicable to all goods not just pharmaceuticals (*see Case 349/95 Frits Loendersloot v George Ballantine & Son Limited [1997] ECR – I 6227; PLC, 1998, IX(1), 68*).

The guidelines allow a trade mark owner to object in situations where the essence of the intellectual property rights (IPRs) is undermined. However, there can be no complaint where it is shown that the owner of the rights deliberately, or otherwise, placed his IPRs in the way of the free movement of goods for reasons that are not objectively justifiable. For example, a trade mark owner cannot object to repackaging which is necessary in order to market the goods in a particular member state.

The view expressed by the Advocate General in *Boehringer* and *Merck Sharp & Dohme* as to when repackaging may be legitimate is as follows:

- Repackaging must be objectively necessary, that is, if it is reasonably required to enable the importer to obtain effective access to the market of the importing member state (or a significant part of it) and in so far as other, less intrusive, methods of repackaging will not enable him to obtain effective access to that market.
- Legal and factual obstacles may make repackaging necessary, and both must be considered. For example, the regulatory requirements of a member state must be taken into account, as must obstacles of fact, such as consumer resistance to over-stickered boxes.
- In every case, the parallel importer (not a third party) must give reasonable notice of the repackaging to the trade mark owner. This requirement is absolute: if notice is not given, the trade mark owner may sue for infringement. In most case, three to four weeks' notice will be considered reasonable.

Although each case will turn on its own facts, the above guidelines will assist both trade mark owner and parallel importer in deciding what can and cannot be done.

WHAT ARE PARALLEL IMPORTS?

Parallel importation occurs where original, genuine goods that have been sold in one market with the trade mark owner's consent are then imported into a second market (the grey market) for resale without the trade mark owner's consent.

Parallel traders must first obtain genuine goods from some point in the supply chain. This may be from the original manufacturer, a distributor, a retailer or some other intermediary. The goods often pass through the hands of various intermediaries before being purchased by the retailer and the retailer may not know the provenance of the goods. These grey goods are commonly either imported into a market in which the brand owner, or his licensee or distributor, sells his goods at a discount to the local price or into a country where the brand owner has chosen not to sell at all.

Cross border trade in counterfeit goods is not an example of parallel imports as the goods are inevitably produced without the permission of the brand owner.

Differing viewpoints

There are arguments for and against parallel imports. Manufacturers of, for example, luxury products will take great efforts to preserve the reputation of their products in European markets and to ensure their orderly marketing.

Parallel imports can destroy local pricing strategies. In some cases there may be a difference in the quality of goods destined for a rich market as opposed to a poorer market. As a result, price will fluctuate depending on the wealth of the particular country and the intended consumer.

However, as pricing strategies can be seen as a form of market partitioning (and therefore contrary to EU principles), brand owners in the EU tend to support their pricing strategies on the basis that parallel imports also have a detrimental effect on quality, product information, guarantees and after-sales service.

Pharmaceutical and cosmetics companies are particularly susceptible to problems caused by parallel importers as they often sell their goods in many countries at considerably differing prices. The position is further complicated for both the brand owner and the parallel trader by the fact that the goods themselves may require repackaging before they can be imported and sold in different members states (*see box "Repackaging of pharmaceutical products"*).

On the other hand, parallel traders argue that IPRs, such as trade marks, are only intended to provide an assurance to the consumer of the origin and perhaps the quality of the goods and that those rights should not be able to be used by the owner to control and divide up the market. Also, where an industry has a web of pricing agreements and relatively controlled distribution of goods, prices are usually higher as compared with markets without such arrangements.

A conflict of laws

The two areas of law that are most relevant to parallel trade are EU intellectual property law and EU competition law. In both areas there has been a lot of European harmonisation, although sometimes there is a conflict between national IPRs and EU principles. The principles of free movement of goods in Article 28 and free competition in Articles 81 and 82 of the EC Treaty are fundamental to the creation, operation and development of the EEA internal market (*see box "Relevant EC Treaty principles"*). However, the ideal of a single market is in conflict with the presence of national IPRs, which, by their nature split the internal market along national lines.

The ECJ has attempted to balance the competing interests of the internal market and the protection of national IPRs.

Relevant EC Treaty principles

- Article 28 prohibits any quantitative restriction on trade between member states, or any measure equivalent to such a restriction.
- Article 30 provides an exception to the rule where necessary, amongst other things, to protect intellectual property rights.
- Article 81 prohibits agreements between undertakings which may affect trade between EU member states and which have as their object or effect the prevention, restriction or distortion of competition within the common market. Any restrictions in contravention of Article 81(1) are automatically void and unenforceable (*Article 81(2)*). An agreement falling within the prohibition may be exempted under Article 81(3) if certain specific benefits to which it gives rise outweigh its anti-competitive effect. Exemption is gained either by means of notification of the agreement to the European Commission for an individual exemption or by ensuring that the agreement complies with the terms of one of the block exemptions.
- Article 82 prohibits firms possessing market power from abusing their dominant position in the common market or a substantial part of it in circumstances where trade between member states is affected.

Trade marks

The words "trade mark" and "brand" are often used interchangeably. Both refer to a sign which can distinguish the goods (or services) of one trader from those of another. A sign includes, for example, words, logos, pictures, shapes, sounds or smells. The main function of a trade mark is to enable customers to recognise the goods of a particular trader.

Trade marks can be registered nationally or Community wide. Once registered, the owner of a trade mark has a monopoly over the use of the mark for the goods for which it is registered. The monopoly can be maintained indefinitely. A trade mark is infringed if it is used without the consent of the owner.

Under Article 7 of the Trade Marks Directive 89/104/EEC:

- The trade mark shall not entitle the owner to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the owner or with his consent (*paragraph 1*).

- Paragraph 1 shall not apply where there exist legitimate reasons for the owner to oppose further commercialisation of the goods, especially where the condition of the goods is changed or impaired after they have been put on the market (*paragraph 2*).

The Directive was implemented in the UK by the Trade Marks Act 1994.

INTELLECTUAL PROPERTY RIGHTS

Trade mark rights are most frequently relied on to prevent parallel imports (*see box "Trade marks"*), although other IPRs may be relevant, particularly when trade mark rights cannot be used. For example, computer software may be protected by copyright in the code and the text of the support manual, trade mark rights and copyright in the packaging, and patent and design rights in the disc and casing on or in which the software is supplied (*see box "Patents and copyright"*).

The owner of a registered trade mark in any EEA country has the exclusive right to prevent third parties from using, in the course of trade, a sign which is identical to his registered trade mark (*Article 5(1), Trade Marks Directive 89/104/EEC*) (the Directive). "Using" includes importing (*Article 5(3)*). However, in the EEA, this right is subject to "exhaustion".

Exhaustion

There are three types of exhaustion:

- National exhaustion. Trade marks are territorial by nature. For example, a Spanish trade mark is not enforceable in any country other than Spain. The principle of national exhaustion provides that there is no infringement of a national trade mark by the use of that trade mark in relation to goods which have been put on the national market by the trade mark owner or with his consent. For example, if a Spanish drinks manufacturer puts his FIZBANG branded soft drinks onto the Spanish market he cannot later object to any resale of those FIZBANG drinks in Spain.

- EEA exhaustion. The principle of EEA, or Community wide, exhaustion is that a trade mark owner cannot use national trade mark law to prevent the resale of goods which have been put on the market anywhere in the EEA by him or with his consent (*Article 7(1), the Directive*).

- International exhaustion. The principle of international exhaustion is that a trade mark owner cannot use national trade mark law to prevent the resale of goods which have been put on the market anywhere in the world by him or with his consent. EU law does not recognise the concept of international exhaustion (*Case C-355/96 Silhouette International Schmied GmbH Co KG v Hartlauer Handelsgesellschaft GmbH [1998] ECR I-4799; PLC, 1998, IX(7), 67*). In order for this policy to change, there would have to be agreement at an international level in the terms of the agreements and treaties that regulate world trade. One of those agreements is the Trade-related aspects of Intellectual Property Rights Agreement (TRIPs). However, during the last round of TRIPS discussions in Uruguay concluded in 1994, the issue of international exhaustion was considered too delicate and was, therefore, not included in the agreement.

Exhaustion is important in the context of free movement of goods throughout the EEA. Once the goods are placed on the EEA market by the owner or with his consent, the owner's rights are 'exhausted', that is, they cannot be used to prevent further dealings in the goods anywhere in the EEA. It is not always clear when consent has been given (*see "Consent" below*).

There are some limitations, however, to the doctrine of exhaustion (*see box "Can you parallel import?"*). In particular, where "legitimate reasons" exist for the trade mark owner to oppose further commercialisation of the goods (*Article 7(2), the Directive*). An example of a legitimate reason would be where the condition of the goods has been changed or impaired in some way after they have been put on the market by the brand owner, or with his consent (*see "Legitimate reasons" below*).

Consent. Consent to first marketing in the EEA can be given either by the trade mark owner or a person legally or economically connected to the owner, such as a member of the same corporate group (*Case C-352/95 Phytheron International S.A. v Jean Bourdon S.A. [1997] ECR I-1729; PLC, 1997, VIII(4), 65*). The question to ask is whether the EEA marketing can be attributed to the trade mark owner because of something he has

Patents and copyright

Patents

A patent is a monopoly right. In the UK, a granted patent gives the owner the exclusive right to use an invention by manufacturing products and putting them into circulation for the first time, either directly or by the grant of licences (*section 60, Patents Act 1977*).

Like trade marks, patents are territorial in nature. The existence of patent rights is not incompatible with the European Economic Area (EEA) free movement of goods principles but, as is the case for trade marks, the exercise of those rights can be limited by EEA law to certain "core rights". For patents, these core rights have been held to be the guarantee that the patent owner has the exclusive right to use an invention by manufacturing goods and putting them into circulation for the first time (*Case C-15/74 Centrafarm v Sterling Drug [1974] ECR 1147).* Therefore, only in certain circumstances are patents capable of being used to prevent parallel imports.

The concept of exhaustion of rights applies to patented goods as it applies to trade marked goods, but this comes from Articles 28 and 30 of the EC Treaty and several European Court of Justice (ECJ) decisions (*see below*) rather than an equivalent provision to that found in the Trade Marks Directive 89/104/EEC (*see box "Trade marks*").

The question of consent is important. A patent owner cannot exercise his national patent rights to prevent the importation into one member state of genuine goods that have been placed on the internal market in another member state, by him or with his consent. In these circumstances the patent owner's rights within the EEA have been exhausted (*Centrafarm v Sterling Drug*). This is the case whether or not patent rights exist in the member states where the patent owner distributes his goods (*Case 187/80 Merck v Stephar [1981] ECR 2063; Case C 267/95 Merck v Primecrown [1997] 1 CMLR 83*).

However, consent is not implied if the patent owner is under a legal obligation (under national or Community law) to market a product in a member state where no patent protection exists. In those circumstances, where the patent owner has no choice but to market his goods, the patent owner is entitled to oppose the importation and marketing of the goods into a member state in which he has patent rights (*Merck v Primecrown*). The same rule applies if patented goods have been made in a member state under a compulsory licence, but are subsequently exported to other member states. The owner of the patent cannot be said to have placed the goods on the EEA market for the first time, or to have consented to that happening (*Case 19/84 Pharmon v Hoechst [1985] ECR 2281*).

The doctrine of exhaustion does not, however, apply to goods placed on the market outside the EU (*Case 51/75 EMI v CBS [1976] ECR 811*).

Copyright

The owner of a copyright work has the exclusive right to exploit a bundle of rights. In the case of a compact disc containing music, this bundle includes the right to prevent unauthorised copying, as well as, for example, the rights of distribution, performance, rental and lending of the compact disc. Copyright can attach to tangible items, such as DVDs, while other copyrights are linked to the provision of services, such as rental rights. Also, different persons may own these different copyrights.

In the context of parallel imports, exhaustion and assessing the question of consent, the fact that copyrights frequently come in a bundle means that each individual copyright must be considered separately. Merely because one copyright in a product is exhausted does not give third parties the right to deal in the other copyrights attached to the product. This is a complex and unclear area. There are no guidelines and the courts have not considered in any depth the relevant issues.

The harmonisation of European copyright law has happened right by right. (The EC Directive (*2001/29/EC*) on copyright has been published and must be implemented before 22nd December, 2002 (*PLC, 2001, XII(7), 86*).) In some cases the doctrine of EEA exhaustion applies to copyrights as it applies to trade mark rights, but in other cases, such as rental rights, it does not apply at all. The exhaustion of copyright in the EEA is determined either by reference to general principles of free movement of goods in Articles 28 and 30 of the EC Treaty, or by reference to bespoke EU laws covering one or more particular types of copyright work.

The EU's policy appears to be that the copyright owner cannot rely on his copyright to prevent the importation of a product that has been lawfully marketed in another member state by him or with his consent, that is, EEA wide exhaustion.

An example of a bespoke law is the Rental Rights Directive 92/100/EEC that requires member states to provide a right to authorise or prohibit the rental and lending of originals and copies of copyright works (*PLC, 1992, III(6), 45*). The Directive provides that:

- Rental and lending rights are not exhausted by any sale or other act of distribution in the EEA.

- Distribution rights are exhausted where the first sale of the copyright work was made in the EEA, by the copyright owner or with his consent.

Similar bespoke directives exist for computer programs (*91/250/EEC)*; databases (*96/9/EC)*; designs (*98/71/EC)*; and semiconductor layouts *(87/54/EEC*).

done, or because of the existence of an economic relationship with a subsidiary company or a third party, such as a distributor. In the case of associated or subsidiary companies (within the trade mark owner's group) the owner is taken to have consented to the conduct of the associated or subsidiary company (*Case C-9/93 IHT Internationale Heiztechnik GmbH v Ideal Standard GmbH [1994] ECR I-2789; PLC, 1994, V(7), 56*).

Consent may be present if the trade mark owner, directly or indirectly, has control over the quality of the goods and the application of the trade mark to the goods (even if such power was not actually exercised) (*IHT Internationale Heiztechnik*).

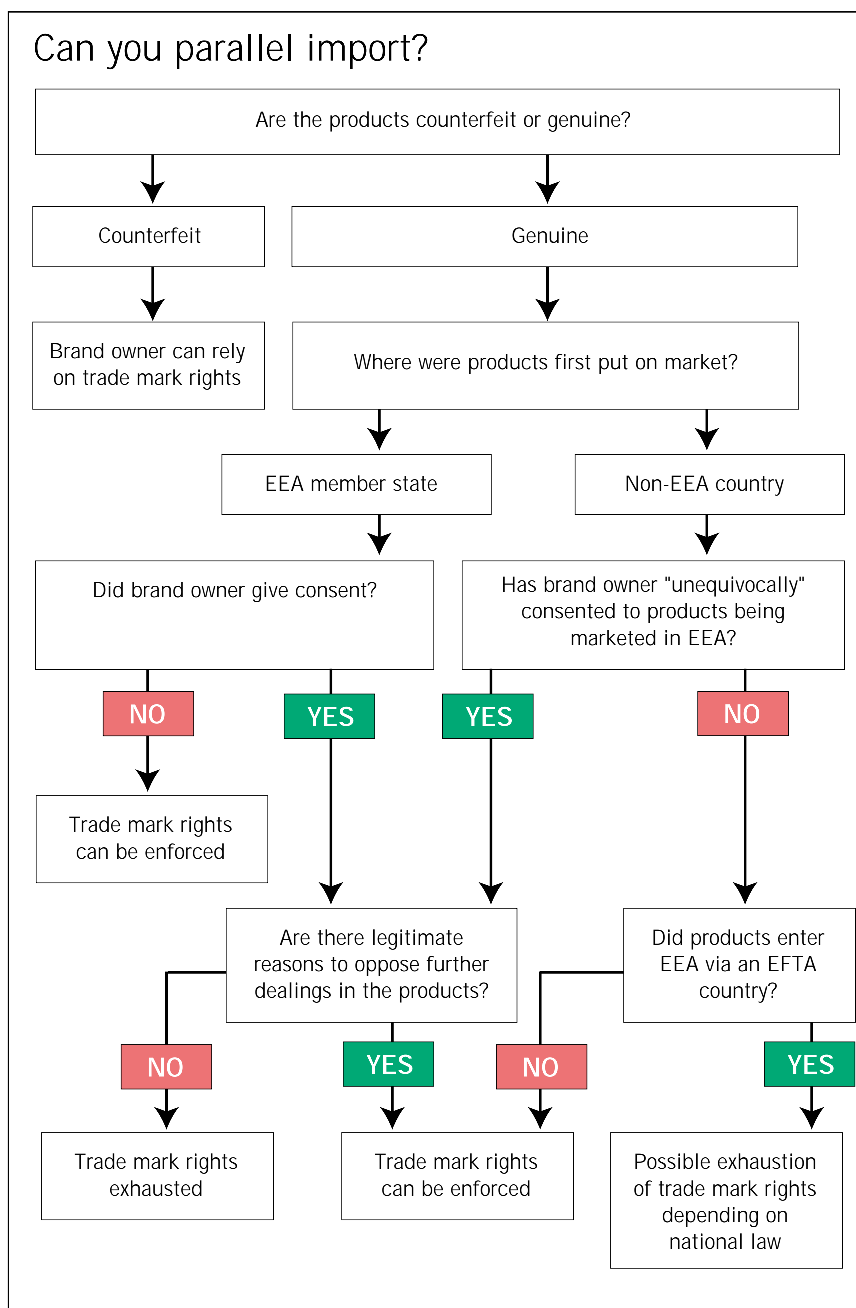
No such power to control is available to the owner of the trade mark if the person applying the trade mark to the goods is unrelated in a corporate sense, or where the trade mark owner has no contractual power to control the quality of the branded goods (*IHT Internationale Heiztechnik*).

Consent is present, and exhaustion occurs, where the trade mark owners in the exporting state and the importing state are different companies, but are economically linked. For example, they may be subsidiaries of the same group of companies (*Phytheron* case).

Where goods originate in the EEA, the relevant consent is the consent to placing the goods on the market of a member state other than the importing member state. Where goods have been marketed outside the EEA and are then imported into the EEA, the critical consent does not relate to the first marketing but to a resale of the goods within the EEA (*IHT Internationale Heiztechnik*).

As Community law does not recognise the concept of international exhaustion of trade mark rights a trade mark owner's EEA rights are not exhausted by putting goods on sale outside of the EEA, or by consenting to the same.

Establishing consent is a question of fact that will differ from one case to another. Because one batch of goods has been sold in the EEA with the brand owner's consent does not mean that every other batch of the same goods, whatever their source, can be imported and sold in the EEA (*Case C-173/98 Sebago Inc. and Ancienne Maison Dubois et Fils SA v GB-Unic SA [1999] ECR I-4103; PLC, 1999, X(7), 79*).



The ECJ has recently given guidance on how consent can be established for goods which originate from outside the EEA in *Levi's v Tesco* when it ruled that for goods originally marketed outside the EEA, it must be clear that the trade mark owner has given his consent to the resale of his goods in the EEA. As consent amounts to the trade mark owner renouncing his exclusive right to control initial marketing in the EEA, the evidence of his consent must be "unequivocally demonstrated". If there is no such evidence of consent, the trade mark owner has the right to stop goods which were placed on the market outside of the EEA from being imported and sold in the EEA. Consent will usually be established from an express statement by the trade mark owner.

Consent is not established:

- By the silence of the brand owner. It is for the trader alleging consent to prove it and not for the trade mark owner to show its absence.

- By the fact that the trade mark owner has not stated, or labelled his goods with a warning, that his goods cannot be sold in the EEA.

- By the fact that the trade mark owner did not contractually restrict any right of resale within the EEA.

Consent may be implied in the absence of an express statement if it can be "unequivocally demonstrated" to the court that the trade mark owner has abandoned his rights, before or after the goods were placed on the market outside the EEA. In practice, implied consent is likely to be difficult to prove and, therefore, rare.

The burden of proving consent, therefore, lies with the parallel trader. The trade mark owner, unless he waives his rights, will control not just when his trade mark may be used, but also where in many parts of the world his goods may be distributed and sold.

Levi's v Tesco is consistent with the EU's policy on trade marks and its economic policy.

Legitimate reasons. Even if consent is established, the trade mark owner can still rely on his trade mark rights, and prevent further commercialisation of his goods in the EEA, if there are "legitimate reasons" for doing so (*Article 7(2), The Directive*). It is not absolutely clear what are "legitimate reasons". There is some guidance in the pharmaceutical products repackaging and relabelling cases (*see box "Repackaging of pharmaceutical products"*) that applies with minor variations to all goods (*Case C-349/95 Frits Loendersloot v George Ballantine & Son Limited [1997] ECR – I 6227*). It is clear from the wording of Article 7(2) that the concept of legitimate reasons is not limited to situations where goods have been repackaged, relabelled or rebranded. It is also relevant where the goods have not been interfered with at all.

In summary, a trade mark owner may have legitimate reasons to oppose further dealings in his branded goods if there has been:

Advertising

The European Court of Justice (ECJ) has recognised the importance of the reputation of cosmetics and their "aura of luxury" arising from their intrinsic quality, their higher price and the manufacturer's advertising campaign. Also, the ECJ is sensitive to the fact that an expensively acquired reputation can be damaged by marketing which detracts from this luxurious image and which was not authorised by the trade mark owner.

Therefore, trade mark rights and copyrights may be used to object to advertising by parallel traders, but only if there is a risk of significant damage to the trade mark and that risk is properly substantiated. However, a trade mark owner cannot prohibit advertising of his goods in a manner which is customary in the reseller's trade unless the circumstances are shown to seriously damage the reputation of the trade mark.

(*Case C-337/95 Parfums Christian Dior [1997] ECR I-6013.*)

- A change or impairment of the condition of the goods after they have been put on the market (*see box "Repackaging of pharmaceutical products"*).

- Serious damage to the reputation of the trade mark (*see box "Advertising"*).

- Actions by third parties that affect to a substantial extent the value, allure or image of the trade mark or the goods to which it is applied (*Advocate General Opinion in Levi's v Tesco*).

- The removal or obliteration by third parties of markings on the goods, such as the removal of batch code numbers that are designed to identify products and/or to comply with EU labelling laws (*Advocate General Opinion in Levi's v Tesco*).

The essential principle of exhaustion is that the marketing of genuine goods by an unauthorised importer is not, of itself, a legitimate reason to resist their resale. It is, however, possible that a brand owner may have a claim for passing off if he sells more than one quality of goods, and a trader passes off the inferior product as the superior product (*see feature article "Passing off: Protecting your brands", PLC, 1997, VIII(8), 25*).

Possible loophole?

In the EU, the principle of the free movement of goods means that exhaustion occurs where goods are legitimately marketed anywhere in the EEA. Whereas in the three EEA states that are not also EU states (Norway, Iceland, and Liechtenstein), known as the European Free Trade Association (EFTA) states, the principle only operates where the first marketing was in the EEA (*Article 8(2), EEA Agreement, applying in the field of IPRs via Articles 11 and 13, EEA Agreement, (corresponding to Articles 28 and 30, EC Treaty)*. This irregularity was supposed to be changed to reflect the EU position by the three EFTA states altering their IPR laws when the EEA Agreement was signed. This has not happened. As a result, and because Norway applies the principle of international exhaustion to trade marks, the three EFTA countries may be a way in which parallel imports of goods that originate outside the EEA can be placed on the EEA market. See *Mag Instrument Inc. v California Trading Co. Norway, Ulsteen* where the EFTA court concluded that it was for the three EFTA states to decide whether to apply the principle of international exhaustion in relation to non-EEA goods (*[1998] ETMR 85*).

This loophole is likely to disappear as the integration of the three EFTA and EU countries is completed, that is when the three EFTA countries join the EU or limit their national law to recognise only EEA wide exhaustion.

COMPETITION LAW ASPECTS

Contracts with distributors or other customers and individual conduct by brand

owners to mitigate the impact of the effects of exhaustion will fall to be examined under EU competition law by parallel traders and the European Commission (Commission). Many of the enforcement actions brought by the Commission in this area have been as a response to attempts by brand owners to control the market in branded products. For example, the imposition of export bans imposed by brand owners on their distributors and other intermediaries in the supply chain; the use of quotas to reduce the likelihood of exports from distributors' home territories; and the use of dual price lists to make intra-EEA exports less attractive to distributors and parallel traders.

The primary objective of Articles 81 and 82 of the EC Treaty is the protection of the EEA internal market (*see box "Relevant EC Treaty principles"*). In consequence, agreements between undertakings that prohibit the movement of products between member states will normally be unlawful. Similarly, the unilateral conduct of a dominant undertaking that has the same effect will also be unlawful. Since trade mark owners will frequently turn to their distribution arrangements to limit parallel trade, it is essential to determine what is permitted and what is prohibited by EU competition law.

Separate trade mark licences

EU competition law does not limit the ability of a trade mark owner to provide separate licences for each member state. The licence may be exclusive or non-exclusive. For example, a manufacturer may appoint an exclusive distributor in France and another in the UK. Each may be licensed to use the relevant trade mark in order to resell and market the products and to take action against local infringements of the trade mark. Exclusive licences may be anti-competitive (because they reduce the number of resellers) but the Commission has provided a broad exemption for many trade mark licences under the vertical agreements block exemption (*Commission Regulation (EC) No. 2790/1999 on the application of Article 81(3) of the Treaty to categories of vertical agreements*) (*PLC, 2000, XI(1), 65*). Vertical agreements are agreements between companies or firms trading at different levels of supply, for example, between a manufacturer and wholesaler, a wholesaler and retailer, or a licensor and licensee. Most trade mark licences that are granted in order to enable the licensee to use, sell or resell a product will be covered by the block exemption. So long as the licences do not contain "hardcore" restraints, the block exemption will automatically exempt them from the Article 81 prohibition without the need to notify them to the Commission (*see box "Hardcore restrictions"*).

Active and passive sales

It is possible to require each trade mark licensee to trade only within his assigned country depending on whether the sales are active or passive. "Active sales" are those achieved through marketing and promoting the products outside the contract territory or through the establishment of a warehouse or distribution depot outside the territory. "Passive sales" are sales made by a licensee, in response to unsolicited orders from outside the allocated sales territory of the licensee or dealer.

A distributor and trade mark licensee can be prohibited from an active sales policy outside his assigned territory except where the supplier has significant market power greater than 30% and the prohibition has an unusual effect on competition (*Commission guidelines on vertical restraints OJ 2000 C/291/01, paragraph 179)*. Where the market share of the supplier is less than 30% then a distribution arrangement that prohibits active sales outside the distributor's territory, but does not contain any hardcore restrictions will be automatically exempted under the vertical agreements block exemption (*see box "Hardcore restrictions"*).

It is not possible to prohibit a distributor from carrying on a passive sales policy outside his assigned territory as this is a hardcore restriction and will be prohib-

Hardcore restrictions

If an agreement meets the conditions in the vertical agreements block exemption regulation (*Commission Regulation (EC) No. 2790/199*) it is automatically exempt from the prohibition in Article 81(1) of the EC Treaty without the need to notify it to the Commission unless there are hardcore restrictions. The hardcore restrictions in this block exemption prohibit:

- Resale price maintenance. The imposition of minimum or fixed resale prices on the buyer (including fixing margins, discounts, rebates and reimbursements).
- Any restrictions on the territories of customers the reseller may serve, except:
  - restricting active sales to the contract territory or customer group;
  - restricting a wholesaler from selling at retail;
  - restricting an authorised distributor in a selective distribution system from selling to an unauthorised dealer.
  - restricting a buyer of components, supplied for incorporation by him into other products, from selling those components to competitors of the supplier.
- Any restrictions on authorised dealers in a selective dealing system on active or passive sales to end users, or supplying other authorised dealers.
- Any restrictions between a supplier and a purchaser of components limiting the supplier to selling components as spare parts to end users or repairers.

ited even if the supplier's market share is below 30%. Essentially, these clauses are regarded as export bans and attract heavy fines from the Commission. For example, when Volkswagen in Italy imposed an export ban preventing its resellers from supplying vehicles outside Italy, the Commission imposed a fine of €31 million (*PLC, 2000, XI(7), 59*). This goes much further than intellectual property law.

Under the exhaustion principle, brand owners lose their rights to control the resale of goods only after they have been lawfully placed on the EU market (*see "Exhaustion" above*). Under the EU competition rules on passive sales, it is unlawful to prevent the first sale of a product as a result of an order placed by a purchaser from outside the distributor's home territory. This places a limit on the first sale to which the brand owner is entitled to withhold consent. Rather than relying on identifying the moment at which trade mark rights can no longer be used in relation to a batch of goods, the passive sales rule prohibits certain territorial restraints being included in trade mark licences. For example, A licences B to resell A's products in Spain under A's trade marks. The licence includes a provision preventing B from responding to unsolicited orders from customers outside Spain. B sells to C in Spain, who seeks to resell those branded products in France. A cannot use its French trade mark rights to oppose that resale, because A's rights are exhausted on the sale by B. B receives an order from D in the UK. Even though the products have not been placed on the market, B must be permitted to resell to D as EU competition law renders the export ban in the licence unenforceable.

Dominant undertakings

Dominant suppliers are under a more onerous requirement as regards passive sales as even unilateral conduct aimed at dividing the EEA into national territories may be subject to EU competition law. It is not necessary for such conduct to be derived from, for example, an agreement between the supplier and the distributor.

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Agreement or not?

The question of whether an agreement exists requires careful scrutiny. Export bans in a specific agreement for sale will be an "agreement" and will be caught by the Article 81 prohibition. Export bans placed in terms and conditions of trade (which are often not specifically agreed to by the customer, but appear as part of the document of sale) require more careful analysis. In a line of cases made before *Bayer* (*see below*), the Commission and the ECJ held that unilateral declarations by a supplier, which form part of the continuing trading relationship between him and his customers can be regarded as an agreement for competition law purposes. For example, where the supplier stamps the words 'export prohibited' on its invoices to distributors, that can form part of the continuing trading relationship between them and consequently will be an agreement (*see Case C-277/87 Sandoz v Commission [1990] ECR I – 45; Joined cases 32/78, 36/78 – 82/78 BMW Belgium v Commission [1979] ECR 2435; Case 107/82 AEG v Commission [1983] ECR 3151; Joined Cases 25/84 Ford and Ford Europe v Commission [1985] ECR 2725; Case 75/84 Metro v Commission [1986] ECR 3021; and Case C-70/93 BMW v ALD [1995] ECR I – 3439*; *PLC, 1995, VI(11), 50*).

In these cases, the feature which defined the relationship as an "agreement" was the presence of a consensus between the supplier and its distributors. Essentially the distributors accepted the export ban by continuing to trade with the supplier on the basis of such terms. This is to be contrasted with *Bayer* where the wholesalers did everything possible to undermine the manufacturer's desires to impose a quota based distribution system (*Case T – 41/96 Bayer AG v Commission, 26th October, 2000; PLC, 2000, XI(11), 73*).

The Court of First Instance (CFI) held that neither the conduct of Bayer nor the attitudes of the wholesalers suggested an "agreement between undertakings" (*PLC, 2001, XII(2), 68*). The Commission is appealing this decision to the ECJ on the grounds that the CFI is requiring a higher level of proof of the existence of an agreement to that previously required under established case law relating to Article 81 of the EC Treaty.

Dual price systems

Dual price systems are prohibited (*Commission Decision Gosme/Martell, OJ 1991, L185/23*; *PLC, 1991, II(6), 41*). For example, in May 2001 the Commission prohibited the dual pricing system that Glaxo Wellcome had introduced for all its pharmaceutical products in Spain as an anti-competitive agreement between the manufacturer and its wholesalers. Under the system, wholesalers were charged different prices for the same product: a lower price for those products which were to be resold in Spain, and a higher price for those to be exported (principally to the UK) (*Commission Decision 2001/791/EC, Glaxo Wellcome, 2001 OJ L 302/1, 17th November, 2001; PLC, 2001, XII(6), 64*).

Refusing to supply

An undertaking in a dominant position must not refuse to supply an existing customer if the object or effect of that refusal is to disable the would-be purchaser from competing in the downstream market (*Cases 6/73 and 7/73 Commercial Solvents v Commission [1974] ECR 223*). Thus any system under which such a dominant supplier monitors the destination of its products and selectively punishes exporting wholesalers, is likely to be prohibited. Undertakings who are not dominant have much greater freedom to select customers. However, where the refusal to supply forms part of the terms of trade between the manufacturer and its wholesalers, it may be prohibited as part of an anti-competitive agreement.

Quotas

In *Bayer,* the company sought to protect its UK subsidiary from parallel imports of drugs purchased by Spanish wholesalers in Spain. The Commission found that Bayer had acted anti-competitively, but the CFI overturned the Commission's decision. Bayer was successful because:

- It did not impose an export ban, it merely restricted all wholesalers to a quota tied to demand in Spain.
- It did not monitor the final destination of the products, nor did it selectively punish any wholesaler that did export.
- It did not seek the agreement of its wholesaler to the quota system. Because there was no agreement between Bayer and its wholesalers, Article 81 did not apply. Since Bayer was not dominant in the market in question, Article 82 did not apply either. Bayer had done everything it could to reduce parallel trade in its products within the law.

Since everything turned on whether or not an agreement existed between the manufacturer and its wholesalers, caution must be used before relying on Bayer unless the facts support such an argument.

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