

11|SB



Branded Sportswear & Equipment

Free Movement of Goods in Europe & Exhaustion of Rights

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The Underlying Issue

1. Branded sports wear and equipment is big business on a global scale. Manufacturing for the global market is increasingly undertaken in the emerging economies particularly the Far East. Well known brands designed and conceived in the west may well be manufactured in, say, China and sold and distributed throughout the rapidly expanding international marketplace. Big profits can be made by international traders by the traditional route of buying genuine product in country A where it is cheap and selling it at a profit in country B where it is expensive (ie so-called parallel importing and the grey market). Consumers approve because they get branded product at lower prices. Brand owners complain that cheap imports wreck their markets and damage their brands. Consumers and traders respond that the brand owners are unfairly maintaining high prices. The public cannot understand. Jacob LJ highlighted this issue succinctly in the Court of Appeal very recently (*Mastercigars Direct v Hunters & Frankau Ltd* [2007] EWCA Civ 176 (at paragraphs 8 - 10)):

“8. I suppose nearly all members of the public would think that you cannot infringe a trade mark if you are just selling the genuine goods of the proprietor to which he has applied his trade mark. Many (probably most) trade mark lawyers think that ought to be the rule. After all, trade marks are the badge of the owner, a sign by which the consumer can know: “Here are the goods or services of a particular owner. I can rely on that

sign." In the language of the Directive the function of a trade mark is to "guarantee the trade mark as an indication of origin".

9. So the public would be surprised to know (and perhaps somewhat resentful of the fact) that the law of the EEA is such that if genuine goods are available outside Europe much cheaper than they are here, traders cannot buy them and import them for sale here, unless the trade mark owner has consented. Even though the trade mark tells the truth, its use can be prevented without that consent.

10. The policy behind this rule has been called "fortress Europe." It has very substantial implications since nearly all goods (save perhaps some raw materials) bear trade marks. It means traders can use trade marks to partition Europe from the rest of the World Market. This can sometimes have beneficial effects (e.g. trade marks are perhaps the easiest of intellectual property rights to invoke to stop re-importation into Europe of pharmaceuticals sold cheaply in third world countries for local use). But generally the rule is self-evidently rather anti-competitive and protectionist. Our task is not to consider whether the rule is good or bad from an economic perspective. It is to apply it.

2. Brand owners can maintain high prices by making those who purchase their goods agree not to sell the product in certain countries (ie the imposition of contractual restrictions) or by enforcing their trade mark rights (or other intellectual property rights such as patent rights) to stop imports. Since consumers don't like high prices for branded product being

artificially maintained in this way a balance needs to be struck between artificially maintained high prices and price regulation by allowing goods to move around freely.

3. All forms of intellectual property grant to their owners some degree of monopoly (the extent of which may vary depending on the right concerned) but such monopoly rights whatever their extent conflict with concept of competition or the free market. A competitive market is one where the restrictions on the sale of goods and supply of services are removed.
4. A trade mark according to the ECJ is "the guarantee that the owner of the trade mark has the exclusive right to use the trade mark for the purpose of putting products protected by the mark into circulation for the first time, and is, therefore, intended to protect him against competitors wishing to take advantage of the status and reputation of the trade mark by selling products illegally bearing that trade mark".

The fundamental principles of the EC

5. One of the ideas of the common market was to create a single economic entity with unrestricted movement of goods within it. The fundamental tenets of the EC Treaty include encouraging fair competition, elimination of barriers to economic progress and progressive elimination of restrictions on international trade reinforced by the provisions of Article 3 namely:

- The elimination of internal restrictions on import and export of goods.
- A common commercial policy and the abolition of obstacles to the free movement of goods.
- Ensuring that competition is not distorted and
- The approximation of laws to the extent required for the functioning of the common market.

Exhaustion of rights

6. Virtually all goods incorporate intellectual property rights of some description. Virtually all incorporate a trade mark (brand). The essential divide is between goods which have been placed on the market inside the EEA with the brand owner's consent and those which have been placed on the market outside the EEA with the brand owner's consent:
- Where goods incorporating intellectual property rights are placed on the market within the EEA with the owner's consent the intellectual property rights are exhausted and by and large the owner cannot prevent their further sale within the EEA.
 - Where goods incorporating intellectual property rights are placed on the market outside the EEA with the owner's consent the intellectual property rights are not necessarily exhausted and the

owner may well be able to prevent the free movement of such goods into the EEA (fortress Europe). The issue will depend upon whether or not the brand owner has unequivocally consented to the goods being sold in the EEA.

Contractual restraints on the movement of goods

7. In a free market sellers of goods are largely free to impose contractual restraints in respect of goods they sell and the owners of intellectual property rights (often the same person or part of a related group of companies) are largely free to control the exploitation of goods subject to their rights by:
- Restricting the right to re-sell and
 - Placing restrictions on importation.
8. Trade mark owners who prevent the importation of goods bearing their marks obviously affect the free movement of the goods concerned. So the exercise of this intellectual property right conflicts with basic tenets of the EC Treaty and forms a fundamental barrier dividing fair and unfair competition. Trade mark rights and patent rights are most often used to prevent imports. This is not always in order to maintain prices. Trade mark proprietors like to control the outlets through which their products are sold (authorised retailers) and, of course, to maintain quality of the product being sold:

- A high quality sporting brand for say expensive skiing equipment and clothing could be seriously damaged if superseded product (old stock) were to be sold cut price at local markets.
- A brand for good quality equipment known for strong after sales support could be ruined if sales were made by unauthorised and unmonitored outlets with no controlled after sales service.

9. How far the owner of intellectual property rights should be allowed to interfere with the free movement of goods by exercising the rights is a matter of much controversy. By enforcing, for example, trade mark rights in each Member State to prevent imports a trade mark owner would be able to control prices in each separate state. The same branded sportswear sold cheap in Bulgaria can be kept out of expensive UK. Trade mark owners can impose terms in license agreements with distributors directly controlling the prices at which product is sold in particular Member States. The common market was supposed to eliminate:

- Price differentials between Member States.
- Interference with the free movement of goods.

10. Provisions in the EC Treaty control such activities and abuses. There are prohibitions:

- On quantitative restrictions on imports and exports and measures

having equivalent effect ¹(exceptions being made eg for measures for the protection of industrial and commercial property).

- Of various restrictive agreements, decisions and practices².
- On abuse of dominant positions within the Community ³.
- On discrimination on the grounds of nationality.

The free movement of goods and exhaustion of rights - goods placed on the market in the EEA

11. Two types of provision affecting the free movement of goods within the EEA are in tension:

- Provisions preventing quantitative restrictions being placed on imports and exports and measures having equivalent effect. ⁴ (The exercise of intellectual property rights (eg a trade mark right) to restrain importation of branded product is a measure having equivalent effect to a quantitative restriction on imports).
- Provisions allowing restrictions to be placed imports and exports

1 Articles 28 - 30

2 Article 81

3 Article 82

4 Arts 28 & 29

on grounds such as morality, public policy, public safety and the protection of industrial and commercial property (eg intellectual property such as trade marks).

12. The balance between free movement of goods and the exercise of intellectual property rights is achieved by imposing the principle of exhaustion of rights on goods put on the market within the EEA. Broadly once goods are sold in the EEA with the seller's consent the seller's rights in those goods come to an end or are exhausted. This is a basic principle in our law of long standing⁵. It is the application of a rule of what would appear to be common sense ie when articles are sold the purchaser owns them and as owner the purchaser should be free to do whatever he wants with them. Broadly *as against the seller* the purchaser is free to resell or use the article anywhere in the EEA. The seller's rights in the goods terminate at the point of the first consensual sale⁶.

Balance between exhaustion of rights and protection of the seller

13. The exhaustion of rights doctrine by and large stops sellers using intellectual property rights to prevent further commercialisation of the

5 *Betts v Willmott* (1871) LC 6 Ch App 239 per Lord Hatherly

6 The rights in the goods might not be completely exhausted because eg other acts may infringe such as making copies thereby infringing copyright.

goods once they have been sold in the EEA⁷ with the consent of the owner of the relevant right.

14. Sometimes, however, it is reasonable that a seller should to be able to enforce his rights to protect his legitimate interests. In such cases a balance needs to be struck between the exercise of the intellectual property rights and the freedom of movement of goods. The balance will tilt towards the exercise of the intellectual property rights where further commercialisation of the goods will prejudice the intellectual property rights. This classically happens when branded goods purchased abroad are re-packaged or re-labelled before being brought into the UK and sold. The repackaging or re-labelling might cheapen the whole look of the goods and damage the brand name⁸ or deceive the public as to the quality or origin of the goods.
15. The following rules apply to determine whether or not the sale of particular goods within the Community has exhausted the relevant intellectual property rights:

- For the owner's rights to have been exhausted in the Community

7 This in fact extends to the EEA because the EEA contains provisions equivalent to Arts 28-30

8 This is enshrined in Art 7 - "1. The trade mark shall not entitle the proprietor to prohibit the 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 exists legitimate reasons for the proprietor 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."

the first marketing of the goods must have been in the Community *with the owner's consent*.

- The particular goods in question (not just that class of goods) must have been placed on the market.
- The consensual marketing of goods in a Member State which lacks protection in a relevant respect will still exhaust the right to prevent further commercialisation of the goods⁹.
- If the proprietor of the intellectual property right (such as a patent) is compelled by law to sell product in a Member State the sale is not consensual and exhaustion does not apply. The proprietor can stop imports of that particular product.
- Proprietors or the licensees who use contractual methods to prevent the subsequent re-sale of products (eg by making it a condition of the sale that the goods will not be exported to particular countries) will be controlled if this activity affects trade between Member States.
- It is sufficient if consent is given not by the actual owner of the trade mark right but by a party which is "legally or economically linked"

⁹ This happened in the case of pharmaceuticals manufactured in Italy (which did not extend patents to pharmaceuticals) and exported to the Netherlands (*Parke, Davis & Co v Probel* [1968] ECR 55).

to it eg if consent is given by one of a group of linked companies. That is sufficient if another member of the group is the actual right holder. This covers situations where the mark may be owned by separate persons in separate states eg products put into circulation by a licensee, a subsidiary or an exclusive distributor¹⁰.

16. Thus placing goods on the market with the consent of the proprietor of the right does not include sales or transfers of goods in Member States between companies within the same group of companies (eg parent and subsidiary). This is because for the purposes of EC law related companies are treated as a single entity. Sales or transfers between group companies do not exhaust the rights. Rights will be exhausted only where the owner of the trade mark has licensed sales of goods bearing the mark within the EEA or has itself or through an associated company marketed goods bearing the trade mark.
17. Sometimes the application of the principle of exhaustion of intellectual property rights might have the effect of seriously damaging the rights in question eg where goods need to be re-labelled or re-packaged by parallel importers to comply with regulations and thereby become suitable for import and re-sale in other Member States. Re-labelling or re-packaging can have a damaging effect on the brand in question by lowering its

¹⁰ What matters is the point of control of manufacture (the decisive factor being the possibility of control over the quality of goods not the actual exercise of the control).

attractiveness and affecting the public's perception of the brand. In these cases other principles come into play¹¹:

- Trade marks legislation dealing with exhaustion of rights couples the principle of exhaustion with a proviso that exhaustion does not apply where legitimate reasons exist for the proprietor of the trade mark to oppose further commercialisation of the goods particularly where the condition of the goods has been changed or impaired¹² after they have been put on the market¹³. This principle applies generally to any subsequent commercialisation of a product which might prejudice or harm an intellectual property right.
- A trade mark proprietor can prevent repackaging unless the exercise of the trade mark rights contributes to the artificial partitioning of the markets between Member States (ie where Member States require that it is done).
- Where eg national rules or practices stipulate certain packaging the exercise of the trade mark owner's rights to prevent repackaging contributes to artificial partitioning but the repackaging must have

11 See Case C-349/95 *Frits Loendersloot v George Ballantine & Son Ltd* [1997] ECR I-6277

12 These examples are not exhaustive. The reputation of a trade mark for prestige or luxurious goods might be harmed by the manner in which the reseller advertises the goods by using the trade mark.

13 Art 7 (2) of the trade marks Directive and Art 13 (2) of the Community trade mark Regulation.

regard to the legitimate interests of the proprietor. A proprietor can oppose repackaging where the parallel importer does it solely to gain commercial advantage.

- Replacement packaging (as opposed to over sticking labels) is objectively necessary where there is likely to be consumer resistance to re-labelling and this is matter of fact and degree for the national court to determine.
- If there is to be repackaging the parallel importer must tell the proprietor about it so that the proprietor can check to ensure that the condition of the product is not affected and the reputation of the trade mark is not damaged. The proprietor needs this provision to have a chance of protecting against counterfeiters.
- It is a matter of objective assessment whether or not the condition of the product or the reputation of the trade mark are likely to be adversely affected by what is done.

Free movement of goods and exhaustion of rights - goods placed on the market outside the EEA

18. The doctrine of exhaustion of rights does not apply to goods that have been placed on the market outside the EEA¹⁴. In such cases the issue is

14 *Silhouette International v Hartlauer* [1998] ECR I-4799 where old designs of branded

whether or not the owner of the intellectual property right has consented to the goods being sold in the EEA. If the owner has consented then the goods can be brought in. The difficulty has been to determine when the owner can be said to have consented. The law on this was comprehensively reviewed by Jacob LJ in the *Mastercigars* case. In that case it was found that the trade mark proprietor had consented to goods (in that case cigars) which were sold in Cuba being placed on the market in the EEA on the grounds that the trade mark owner not only tolerated but allowed small commercial quantities to be purchased by foreigners within Cuba for them to take out and re-sell abroad.

19. In the earlier Davidoff and Levi Strauss case¹⁵ Davidoff's toiletries were placed on the market outside the EEA in Singapore and Levi's jeans were placed on the market in Canada, the US and Mexico. In both cases the goods were imported into the UK for sale (the jeans were for sale in Tesco and Costco). The following findings were made:

■ The proprietor's rights were not exhausted by placing the goods for

spectacles were sold off in Bulgaria and imported into Austria (where trade mark law appeared to countenance international exhaustion of rights). It was held that Art 7 (1) applied to exhaustion in respect of goods placed on the market within the EEA only and could prevent the importation of goods from outside the EEA even if they had been placed on the market there with the trade mark owner's consent

15 *Zino Davidoff AG v A&G Imports Ltd* [2001] ECR I - 4103

sale outside the EEA and the proprietor was able to control the initial marketing in the EEA.

- The proprietor's consent to further marketing of the goods (and renunciation of intellectual property rights) must have been unequivocally given and would normally require an express statement of consent. However, it is for the national court to decide whether the facts and circumstances prior to or simultaneous with or subsequent to the placing of the goods on the market outside the EEA unequivocally demonstrates that the proprietor had renounced his rights to object to further commercialisation within the EEA.
- The mere failure of the proprietor to object to marketing in the EEA or the failure to place prohibitions on the goods themselves or to impose contractual restraints on the further marketing of the goods in the EEA would not amount to facts from which consent to marketing in the EEA could be inferred.
- It is for the person alleging that the proprietor has consented to marketing in the EEA to prove that such consent has been given.

20. In the *Mastercigars* case Jacob LJ agreed that the following propositions were also applicable:

- For their to be consent on the part of the trade mark proprietor such consent must relate to each individual item of product in respect of which exhaustion of rights is claimed.

- Implied consent on the part of the trade mark proprietor cannot be inferred from:
 - The fact that the trade mark proprietor has not communicated opposition to marketing within the EEA to all subsequent purchasers of goods placed on the market outside the EEA or
 - The fact that the goods carry no warning or prohibition on their being placed on the market within the EEA or
 - The fact that the owner has transferred ownership of the goods without imposing a contractual reservation and that, according to the law governing the contract, the rights transferred include, in the absence of such a reservation, an unlimited right to resale or at least a right to market the goods within the EEA.
- The onus lies upon the importer to prove consent express or implied but not to the criminal standard of beyond a reasonable doubt.
- It is sufficient if consent is given not by the actual owner of the trade mark right but by a party which is “legally or commercially” linked to it. So eg if consent were given by one of a group of linked companies, that would do if another member of the group were the actual right holder. This would cover consent given by a licensee,

by a parent company, by a subsidiary or by an exclusive distributor. What is important is that the trade mark is able to guarantee that all goods bearing the mark have been produced under the control of a single undertaking which is accountable for the quality of the goods. The origin which the trade mark guarantees is not the manufacturer but the point of control of manufacture and it is not the actual control of manufacture that matters but the possibility of control over the quality of goods.

21. In the *Mastercigars* case Jacob LJ found that it was blindingly obvious that the trade mark proprietor was saying to the distributors in Cuba that they could sell small but commercial quantities of the goods to foreigners with appropriate documentation enabling the foreigners to take the goods home to sell. This showed that consent to use the trade mark on the purchaser’s home market was given and the unequivocal test was passed. There was consent in these circumstances to a trickle of small but commercial consignments going on the market in Europe. The consent, it must be emphasised, related only to each individual small consignment.
22. In practice in order to avoid the possibility of a finding that there has been consent to the sale of goods within the EEA proprietors will make it clear to their distributors and retailers that the goods are not for sale within the EEA and might even add a note on labels or stickers attached to the goods.

23. Trade mark owners often try to keep goods out of the Common Market where parallel imports might harm the brand eg in the case of a luxurious brand the trade mark owner would not want inferior quality product finding its way in from outside or have product coming which is sold in downmarket outlets or where in circumstances where the after sales service is of poor quality. Trade mark owners like to control these things because they can seriously affect the credibility of the brand¹⁶.

Disparities between national laws

24. Sometimes different Member States have different internal rules which apply to particular types of product which might prevent the sale of the product in that state (eg health and safety or consumer protection regulations). Such differences in national laws are okay even though they inhibit intra-state trade provided that they:
- Apply to domestic and imported goods without distinction and
 - Were necessary to satisfy overriding requirements relating inter alia

¹⁶ There is the well known case of the inferior quality Colgate toothpaste imported from Brazil into the UK (but still genuine product). The trade mark owner was able to stop these imports partly on the ground that in the UK the brand was a badge of quality and consumers would be deceived if they bought Colgate toothpaste and did not get the UK product but something inferior. Of course now as a result of Zino Davidoff the trade mark owner does not have prove detriment or other adverse effect because the owner of the trade mark can simply object to the goods from outside the EEA being brought in.

to consumer protection and fair trading (ie that the risk of misleading consumers was sufficiently serious to justify the barrier and the prohibition was proportionate to that objective such that no other less restrictive measure would do the job).

25. Freedom of movement of goods is the overriding principle so where it conflicts with national laws the Member State must justify the obstacle to free trade between Member States and must see if they are alternative ways of achieving the objective of the national law without interfering with the freedom of movement of goods.

Summary:

26. The exhaustion of rights doctrine applies to all forms of intellectual property (patents, trade marks and some copyrights and designs).
27. The exhaustion of rights doctrine broadly provides that the owner or licensee of an intellectual property right cannot rely on that right to prevent the importation of goods from another Member State of the EEA if those particular goods have previously been marketed in that or another Member State with the consent of the owner of the right.
28. Apart from the position within the EEA there is no international exhaustion of rights doctrine. The rights conferred by, say, a trade mark are exhausted only

if the products are put on the market within the EEA with the owner's consent. If goods are put on the market outside the EEA with the owner's consent the trade mark can be used to prevent the goods being imported into the EEA unless the owner of the right has unequivocally consented to the goods being placed on the market in the EEA.

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Summer 2007

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Robert has broad experience in chancery, commercial and business related civil litigation with specialist knowledge in intellectual property and media and entertainment. His expertise extends to banking and guarantees, partnership, construction, fraud and asset tracing and professional negligence. Primarily known as a litigator he has undertaken many heavily contested often high profile trials and devoted a substantial part of his practice to specialist advice work. He is an experienced interlocutory litigator particularly in relation to freezing and search orders and other interim remedies.



His intellectual property practice ranges from trade marks to copyright, patents and design right work and he has extensive experience of defamation and privacy claims. He has chaired and for some years delivered lectures at the annual intellectual property law and sports law conferences for London Legal Training. His lecture topics have included privacy and image rights, performers' rights, performers' royalties, database rights and freedom of movement of goods.

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