Recent U.S. And EU Developments: The Exhaustion Theory Is Not Yet Exhausted

By Erik Verbraeken

Although this article will compare recent developments in both the U.S. and the European Union with respect to the application of the exhaustion of intellectual property rights, the focus of this overview will be laid on the application of the exhaustion theory in the European Union, using U.S. case law as a source of inspiration.

The exhaustion theory has been developed by the European Court of Justice in the early seventies in order to define a bridge between two incompatible provisions of Community law: on the one hand the fundamental principle of the free movement of goods, enshrined in article 28 (formerly article 30) of the Treaty of Rome, in accordance with which a product, once introduced on the European marketplace, should circulate freely without being subject to trade restrictions or other measures having equivalent effect, and on the other hand the mandatory requirement of the protection of intellectual property rights, recognized in article 30 (formerly article 36) of the Treaty of Rome, and supported by the provisions of article 295 (formerly article 222) according to which the Treaty "shall in no way prejudice the rules in Member States governing the system of property ownership," that may justify a derogation from this fundamental principle.

Under the respective national laws of each member state of the European Union, intellectual property holders have certain exclusive rights with respect to the subject matter of the property right, whether this be a patent right, a trademark right, a copyright, or any other intellectual property right recognized under national law. For example, under the legislation of France, the following actions are prohibited when they are the subject of a patent claim recognized in France:

(a) Making, offering, putting on the market or using a product which is the subject matter of the patent, or importing or stocking a product for such purposes;

(b) Using a process which is the subject matter of the patent or, when the third party knows, or it is obvious in the circumstances, that the use of the process is prohibited without the consent of the owner of the patent, offering the process for use on French territory;

(c) Offering, putting on the market or using the product obtained directly by a process which is the subject matter of the patent or importing or stocking for such purposes.

It is therefore that, prior to the entry into force of the Treaty of Rome, the importation of a product from one country into another country was considered to be an act of infringement of the patent right if the importation was made without the consent of the patentee.

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Since article 30 of the Treaty of Rome recognizes that the protection of national IP rights are a legitimate national interest that are to prevail over the Community interests of the free movement of goods, the question arose whether these interests continue to prevail when the goods are introduced on the territory of one member state by the patentee himself or with his consent, and subsequently imported on the territory of another member state through the regular channels of trade.

The European Court of Justice had a first opportunity to reconcile article 28 with article 30 in 1974, as a result of infringement proceedings brought by Sterling Drug Inc. against Centrafarm for the importation of pharmaceutical products, originally sold by authorized licensees of Sterling Drug in the UK, on the territory of The Netherlands (case 15/74, judgment of the Court of 31 October 1974). In this quintessential judgment of the European Court, it laid the groundwork for what has now become known as the European exhaustion theory. On the basis of the premise that "whilst the Treaty does not affect the existence of rights recognized by the legislation of a Member State in matters of industrial and commercial property, yet the exercise of these rights may nevertheless, depending on the circumstances, be affected by the prohibitions of the Treaty," the Court ruled that "inasmuch as it provides an exception to one of the fundamental principles of the common market, article 30 in fact only admits of derogations from the free movement of goods where such derogations are justified for the purpose of safeguarding rights which constitute the specific subject matter of this property." The specific subject matter of a patent right was then defined to be "the guarantee that the patentee, to reward the creative effort of the inventor, has the exclusive right to use an invention with a view to manufacturing industrial products and putting them into circulation for the first time, either directly or by the grant of licences to third parties, as well as the right to oppose infringements." On the basis of these considerations, the Court's ruling then held that "the exercise, by a patentee, of the right which he enjoys under the legislation of a Member State to prohibit the sale, in that state, of a product protected by the patent which has been marketed in another Member State by the patentee or with his consent is incompatible with the rules of the EEC Treaty concerning the free movement of goods within the common market."

The European Court has since had the opportunity to fine-tune its case-law on the subject of the exhaustion of intellectual property rights, in particular in the area of patent rights and trademark rights. However, the matter has proven sufficiently rich and heterogeneous to deduce that there still exist many variants which have not (yet) passed the scrutiny of the European Court, and which therefore inspire the title of this article that the exhaustion theory of the European Court of Justice is still far from being exhausted. The purpose of this article will be, after a short review of the cases that were brought before the European Court after the 1974 Centrafarm decision, (1) to examine the remaining gaps in the exhaustion theory, by focusing on some of the uncertainties that remain with respect to the exact interpretation and contours of some of the terms used by the European Court in defining the specific subject matter of a patent right, (2) to put these gaps in perspective with some of the cases reviewed by other courts, in particular in the United States and in France, and (3) to use these decisions as a source of inspiration to further extend and precise the definition of the exhaustion principle in the European Union.

Although the exhaustion theory applies to patent rights, trademark rights, copyrights, and other intellectual property rights alike, this article will focus on patent rights. However, when need be, a bypass may be made to other intellectual property right cases where the conclusions of the European Court can likewise be used for the purpose of the identification of the contours of the patent exhaustion doctrine.

Furthermore, when examining the "variants" which have not yet passed the scrutiny of the European Court, these hypothetical cases will be considered against the background of the French legislation, in conjunction with the case-law of the European Court of Justice.

The Initial Development of the Patent Exhaustion Theory After Centrafarm

Following the European Court's milestone judgement in the Centrafarm case, further direction was given to the concept of the exhaustion doctrine in the following cases.

The Merck–Stephar case (case 187/80, judgment of the Court of 14 July 1981)

In the case brought by *Merck & Co. Inc against Stephar BV*, Merck had marketed a certain drug in Italy where it had not been able to obtain a patent owing to the fact that at the time when the drug was sold in Italy, the Italian patent law prohibited the grant of patents for drugs and their manufacturing processes. The drug was subsequently imported from Italy by Stephar and marketed in The Netherlands.

Merck reasoned that under these particular circumstances, the purpose of the patent, which is to reward the inventor, is not safeguarded since, in the absence of a patent right in Italy, he has been unable to collect his monopoly reward for his creative effort. However, although the reward of the inventive effort of the patentee through the possession of a monopoly on the exploitation of the patented product is recognized to be the essential function of the patent right, the Court underscores that this privilege of the patentee does not guarantee that he will obtain such a reward in all circumstances. According to the Court, the substance of a patent right lies essentially in according the inventor an exclusive right of first placing the product on the market. It is then for the proprietor to decide under what conditions he will market his product, including the possibility of marketing it in a Member State where the law does not provide patent protection for the product in question. If he decides to do so he must then accept the consequences of his choice as regards the free movement of goods within the common market.

The Pharmon–Hoechst case (case 19/84, judgement of the Court of 9 July 1985)

In the case brought by *Hoechst AG against Pharmon BV*, the question arose whether the patent rights of Hoechst were exhausted as a result of the manufacture of some of its patented medicines under a compulsory license obtained by a British company DDSA Pharmaceuticals Ltd, following the sale of a consignment of these medicines to a Netherlands pharmaceutical company Pharmon, despite a prohibition on exportation attached to this compulsory license.

Having regard to the particular nature of a compulsory license, where the public authorities of a Member State grant a third party a compulsory license which allows him to carry out manufacturing and marketing operations which the patentee would normally have the right to prevent, the Court held that the patentee cannot be deemed to have consented to the operation of that third party; in fact, such a measure deprives the patent proprietor of his right to determine freely the conditions under which he markets his products. In that respect, it makes no difference whether a prohibition on exportation is attached to the compulsory license, whether the license fixes royalties payable to the patentee, or whether the patentee has accepted or refused such royalties.

The Merck–Primecrown and Beecham-Europharm cases (joined cases C-267/95 and C-268/95, judgment of the Court of 5 December 1995)

Under these joined cases, the factual context was similar to the prior Merck–Stephar case, it being understood that the drugs were originally sold in Spain. As a result of the accession of Spain to the European Community, a transitory period was enacted in the Accession Treaty during which patent holders in Member States were authorized to oppose the importation of drugs that they had first marketed in Spain, where pharmaceutical inventions were not patentable, in attendance of the amendment of the Spanish laws to provide for full protection for pharmaceutical inventions. After the expiry of the transition period, Merck and Beecham continued to oppose the importation of drugs that they introduced on the Spanish market after the accession of Spain to the European Community but before the product could be protected by a product patent in that country.

Despite the arguments of Merck and Beecham, in part supported by the Attorney General, to reconsider the rule in *Merck vs. Stephar* having regard to the specific circumstances of this case and the recognition of the importance of pharmaceutical patents by the European institutions, the European Court maintained its ruling that, even if it is now the norm for pharmaceutical products to be patentable, if a company decides, during a period that such products were not patentable in a given country, to market these products in that country, he must then accept the consequences of his choice as regards the free movement of the product within the common market.

The Court held further that an exception to this principle may be accepted where the company can prove that he was under a legal obligation to market the product concerned in the exporting State, provided that such obligation can be shown to be a genuine existing obligation. As regards the argument that ethical obligations may compel patentees to provide supplies of drugs to member States where they are needed, such considerations are not, in the absence of any legal obligation, such as to make it possible properly to identify the situations in which the patentee is deprived of his power to decide freely how he will market his product.

Conclusions

Although the European Court of Justice appropriately construed a basis for the peaceful co-existence of articles 28 and 30 of the Treaty of Rome with the definition of the exhaustion theory in the Centrafarm decision, and gave further guidance with respect to the boundaries of the exhaustion theory in the above mentioned decisions, it also introduced a new field of tension in the area of the exercise of a patent right by the patent holder by combining the specific subject matter of a patent right, i.e. the exclusive right to put the product into circulation for the first time, whether directly by himself or indirectly with his consent, with the essential function of the patent right, i.e. an instrument to obtain a reward for his inventive efforts. This tension is most discernible from the comparison between the two Merck cases on the one hand, and the Pharmon–Hoechst case on the other hand. While in the Merck cases, although the patentee did not derive a "monopoly reward" from the sales of his product in Spain (the revenues derived by Merck were mere "market price rewards" that did not, as such, reward Merck for its inventive efforts, represented by the patent), the Court concluded that the products were nevertheless marketed with the consent of Merck, in Pharmon–Hoechst the Court came to the opposite conclusion although it might be expected that under the obligatory license, the patentee obtained a reasonable financial reward.

Since the Court's case law on exhaustion focuses foremost on the parameter of consent, the main question that will be examined hereunder is what particular type of consent is required in order to admit that, in the words of the Court in the Pharmon–Hoechst case, the proprietor has exercised his right "to determine freely the conditions under which he markets his products." Since the question of consent relates to the introduction of the product on the marketplace, a first inquiry will concern the moment that the patentee has effectively put the product into circulation, in such a way that he can be considered to have purged the essential function of the said right.

The Introduction of the Product on the Market

In accordance with the decision of the European Court in Centrafarm, the patentee can be considered to have reaped the full benefit of his patent right when he has put the product into circulation for the first time, either directly or by the grant of licences to third parties. The question thus arises at what particular stage of commercialization the product can be said to have been put into circulation by the patentee.

The Court was given a first opportunity to provide further guidance on this issue in the Pharmon–Hoechst case, following a decision of the Regional Court of Appeal of The Hague (The Netherlands), which took the view that, since Pharmon had bought the consignment of pharmaceutical products in question directly from the licensee, the tablets had not yet formally been released onto the market. Unfortunately, the European Court of Justice did not further elaborate on the issue raised by the national court, since it solved the case by founding its decision on the absence of consent by the patentee when the product is sold on the marketplace through a compulsory license.

It was not until 2002 that the European Court was given the opportunity to elaborate on the question of the particular moment of time when the products are put onto the market. The issue was raised in a trademark case opposing *Peak Holding AB against Axolin-Elinor AB* (case C-16/03, judgment of the Court of 30 November 2004) where, after the trademark proprietor had in vain tried to sell the trademarked products (clothing and accessories) through its own distribution channels, it decided to supply the remainder to a French company COPAD, under the condition that the consignment should not be resold in countries in Europe other than Slovenia and Russia. Nevertheless, Axolin–Elinor acquired a consignment of about 25,000 garments, that it put up for sale in Sweden. Axolin–Elonor submitted that the goods at issue had been put onto the market by or with the consent of Peak Holding, by virtue of having been offered for sale by independent resellers, including through the proper stores of Peak, even if the offer is not taken up.

The Swedish District Court went along with this reasoning, holding that the goods had been put on the market by virtue of the fact that they had been offered for sale to consumers through the commercial network of Peak. A similar reasoning has been upheld recently in France where the introduction of the product on the marketplace was implied as a result of the mere presentation of the product in the catalogue of the company; according to the tribunal, every material operation that is intended to put the product into circulation is to be considered as an introduction of that product on the marketplace (Tribunal de Grande Instance de Paris, judgment of 20 June 2003, *GEA Erge Spirale vs. Thai NV*).

The European Court, however, did not concur with such an extended interpretation of the concept of market introduction. Where a proprietor offers goods for sale in the European Union, he does not put those products on the market. Such acts do not transfer to third parties the right to dispose of the goods bearing the trademark; besides, they do not allow the proprietor to realise the economic value of the trademark.

This last consideration of the European Court bears an important element which can be extrapolated to our patent context, i.e. the realization of the economic value of the property right exhausts the exclusive right of the same. This consideration thus puts on the center stage the essential function of the property right. A mere offer to sell the product does not, as such, permit the patentee to recover a reasonable reward for his invention, since the commercial offer does not yet trigger the reward for the patentee, i.e. through a patent profit margin if he offers the product directly to its clients, or through royalty payments when the offer is made through its licensees.

Although the Peak Holding case clarifies that offering the goods for sale is not equivalent to putting the same on the market, one question still remains: what entity physically represents the "market" to whom the goods have to be sold in order for exhaustion to occur? Between the signature of the first license agreement where the patentee consents to the sale of the patented products by the licensee, and the ultimate purchase of the product by the final consumer/end-user, there may be many trade points where the product "changes hands," in particular through wholesale transactions, forwarding agency deals, geographical network arrangements, etc. Although the past position of the European Commission that the simple grant of a patent license anywhere in the EC amounts to an exhaustion of all corresponding patent rights everywhere in the EU in respect of the patents made under that license (J.R.C. Brown, Parallel Imports, Exhaustion of Rights in EU, in *les Nouvelles*, June 1997) certainly no longer stands (cf. conclusions of Advocate General Kokott in the Christian Dior case, discussed in the next chapter), the question remains: what specific action does amount to exhaustion? For instance, does exhaustion take place where the first sale is made merely within the framework of an administrative, "in-house" corporate transaction, corresponding to the internal organization of the company group and the respective commercial responsibilities attributed to each corporate entity of the group?

This issue was raised before a French tribunal in 1993, when the British company ICI plc introduced infringement proceedings against the French company Phyteron International SARL for the importation into

France of an insecticide for which ICI held a patent. This particular product was first sold by ICI plc to its affiliated company ICI Turkey in Great Britain, for the purpose of the resale of this product on the Turkish territory. Following the introduction of the product on the Turkish marketplace, the insecticide found its way back to the European market through a further resale of this product respectively to Germany (purchaser, Chembico GmbH) and France (purchaser, Phyteron International SarL). In its defence to the patent infringement claim introduced by ICI, Phyteron affirmed that as a result of the intra-group sale between ICI plc and ICI Turkey in Great Britain, the product was put into circulation on the European market and the patent right of ICI was exhausted. Although Phyteron invited the French tribunal to submit a prejudicial question to the European Court on this particular topic, the latter found that it needed no further instructions from the European Court since, "evidently," for a product to be put into circulation, it should have been put at the disposition of the consumer. In the exact words of the French tribunal: "un acte de mise en circulation suppose, à l'évidence, une réelle mise sur le marché, à la disposition de la clientèle." Since an intra-group transaction does not make the products available for the consumer, the product cannot be said to have been put into circulation.

It is interesting to notice that the Attorney General Stix-Hackl, in his opinion on the Peak Holding case, raises the issue in order to conclude that the "market-driven" language of article 7(1) of Directive 89/104, enshrining the exhaustion principle for trademarks, implies that internal transactions, such as the transfer of goods bearing the mark to a retail subsidiary, cannot be considered to constitute the putting on the market of the goods bearing the mark.

However, at the same time, where the first commercial transaction, even when the latter is strictly internal, gives rise to a payment, the essential function of the patent may be considered fulfilled, since under such a scenario, the patentee has received its commercial reward in relation with the sale. Because "in-house" corporate transactions have to be made on arms length conditions in order to avoid their annulment on the basis of principles of fiscal or commercial law, the patentee may be expected to have derived a reasonable reward from the transaction–and therefore exhausted its exclusive rights to control the further commercialization of the product. It would not seem audacious to conclude that exhaustion takes place under the first deal where, in consideration of the product "changing hands," the patentee obtains a financial reward.

Another issue that was raised before the European Court in the Peak Holding case for which, unfortunately, no need to answer it was identified by the Court (the question was asked only if the answer to the prior question was affirmative which was not the case) consists in the "interruption" of exhaustion when the goods are returned to the proprietor. In the Peak Holding case, where the trademark rights were not exhausted by the offer for sale, there was indeed no need to establish a possible subsequent interruption of the exhaustion when the goods are restored in the proprietor's warehouse. Nevertheless, the question has a high practical interest where a valid sale is subsequently annulled by the purchaser, either for contractual motives (the products may be defective) or for commercial motives (the seller voluntarily concedes to the request of the purchaser to annul the "ill-considered" transaction). Suppose the Peak Holding case arose because Peak Holding had supplied the garments to Copad as a result of a prior annulment of the purchase transaction by the client, and then decides to allot the said consignment for shipment to markets outside the European Union? Might the exhaustion, that certainly arose as a result of the first sale, be considered restored or interrupted because of the subsequent annulment of the sale? Under our patent context, the essential function of the patent right would tilt towards a negative answer, since the annulment of the sale would likewise annul the financial reward of the patentee. However, the Merck cases may undermine this reasoning in accordance with the Court's holding that the privilege of the patentee does not guarantee that he will obtain such a reward in all circumstances–by consenting to the first sale, the proprietor may thus be considered to have accepted the full consequences of this choice, including possible future annulments of the sale.

Because of the regional scope of the exhaustion theory, implying the exhaustion of the patent right only as a result of the introduction of the product on the marketplace of a Member State of the European Union, to the exclusion of any first sale on a market outside the European Community territory (cf. *EMI vs. CBS*, case 51/75, judgment of the Court of 15 June 1976, and *Silhouette vs. Hartlauer*, case 355/96, judgement of the Court of 16 July 1998), it also becomes necessary to pinpoint the exact geographical location where the product has been put on the market "for the first time" in international dealings. The question that therefore arises is: at what particular market stage can we consider that a product has really been put "into circulation" into Europe? For example, if a French patentee sells a batch of products to a Russian client, where has the product been geographically put "into circulation"? Various answers will have various (and far-ranging) consequences on the issue whether the French patentee has exhausted its patent right. Should the product be considered to have been put into circulation at the place where the products were physically stored at the moment that the agreement was concluded? Or at the place where they were brought following the execution of the agreement? Does it matter whether the agreement has been signed in France or in Russia? Does it matter whether the sales agreement is subject to French law or Russian law? Does it matter whether the sales are made on an "ex-works" basis (where the client takes delivery of the products in France) or on a "DPA" basis (where the client takes delivery of the products in Russia) under the Incoterms 2000? Does it matter whether property title passes when the products are still in France (which would be the case if the agreement was governed by French law, since property passes at the time of signature of the agreement) or when they have been delivered in Russia and fully paid for (which would be the case if the agreement contained a property reservation clause)?

It would be very awkward, and a considerable nuisance to subsequent purchasers of the product, if the answer to this question would depend on the exact terms of the agreement and the fulfilment of these terms by the parties. It would seem reasonable to argue that the products can be deemed to have been put into circulation in the country where the products have been physically delivered by the patentee, in order to avoid the exhaustion of his rights merely as the result of the outcome of a commercial negotiation between seller and purchaser. The determination of the point where the goods are effectively put into circulation should therefore be provided independently from the commercial and contractual terms of the sales agreement. Although this abstraction from the terms of the agreement would avoid most nasty surprises for the patentee when confronted with an exhaustion argument raised by a subsequent purchaser on the basis of, let's say, a "place of sales" pleading when the sales agreement was concluded under an "ex works" delivery clause, it will not eliminate altogether the importance of contractual clauses if the seller wishes to avoid the exhaustion of his patent right when the products are subsequently re-introduced on the European market. For example, if the seller agrees to sell the products at a considerable reduced profit margin in view of the commercialization of these products on Russian territory, thus retaining his patent rights when the products are further traded and re-imported to Europe, the seller will have an interest to introduce a "final destination" clause in his contract; in the absence of such clause, nothing would prevent the Russian purchaser, taking delivery of the products at the factory site of the seller under the "ex works" clause, to make a subsequent deal with, say, a German customer who would thus be able to dispose of the goods on the German market and undercut the market prices practised by the patentee himself on that market. Since the first sale was made by the patentee who freely determined the conditions of sale of his product, in the absence of a "final destination" clause, the patent right of the patentee would be exhausted through this sale.

The "final destination" clause provides us the bridge to proceed to the next chapter, i.e. as from what particular action a patentee can be said to have "consented" to the introduction of the product on the marketplace. For example, if the goods were sold in Germany in breach of the "final destination" clause, can the patentee legitimately argue that its patent rights have not been exhausted under the circumstances?

The Consent Of The Patentee To Put The Product Into Circulation

The patent right will only be exhausted when the product has been put into circulation with the consent of the patentee. The contractual freedom of the parties to negotiate and agree on the constituent terms of their commercial operation implies that the patentee may demand several restrictions and prohibitions when dealing with a third party, whether the latter be an end-user when the patentee sells the products directly to the market, or a distributor when the products are sold through distribution networks, or a licensee when the products are locally manufactured and sold by a designated third party. All of these agreements may contain specific restrictions, i.e. a "single use only" clause in a sales agreement, a "final destination" clause or "export restriction" clause in a distribution agreement, or a "quality control" clause in a license agreement. The question arises whether the sale of the product in breach of the contractual terms prevents the patent right from being exhausted for lack of "consent" to the sale by the patentee, or whether this breach of contract should be considered to have been made at the risk of the patentee, whose consent may be considered to have been acquired through the sole conclusion of an agreement with his purchaser–distributor–licensee where the latter were authorized to commercialize the products, and where the respect of the contract terms of this agreement becomes a mere private and bilateral matter between the contracting parties that should not impact the exhaustion of the patent rights when the products are traded in violation of the terms of the agreement.

Surprisingly, we had to wait until 2004 before the European Court was presented with a reference for a preliminary ruling under article 234 of the Treaty on this subject matter. Although prior cases were brought before the Court where restrictive contract clauses conditioned the consent of the patentee to the further sales of the product (e.g., in Pharmon–Hoechst, the compulsory license included an export prohibition for the licensee, and in *Javico vs. Yves Saint Laurent*, case C-306/96, judgment of the Court of 26 April 1998, the agreement was made subject to a "final destination" condition), the issues raised were decided on grounds that were not related to the alleged absence of consent by the patentee as a result of the particular structuring of the contract terms and conditions.

Nevertheless, the question raises important business issues since it implies that exhaustion can be prevented by "booby-trapping" the agreement with restrictive clauses. This practice of "contracting around exhaustion" has been accepted in the United States, both with respect to limited licences and limited sales. Where the patentee grants a license with field of use restrictions and the licensee (or its customers) transgresses this restriction, it has been held that the patentee can oppose its patent against the resale of the product in a market that is outside the licensed perimeter (*General Talking Pictures vs. Western Electric,* 304 US 175, 1938). Likewise, where the patentee puts the product himself on the market with a post-sale restriction conditioning such sale, the non-respect of these post-sale restrictions can be sanctioned through a patent infringement procedure, as a result of the decision of the Court of Appeals for the Federal Circuit in the case *Mallinckrodt vs. Medipart* (24 USPQ 2d 1173).

Before addressing the 2004 European Court decision in Peak Holding, and the subsequent recent decision of the European Court in *Copad vs. Christian Dior* (case C-59/08, judgment of the Court of 23 April 2009), a brief presentation of the above cases may be useful.

The General Talking Pictures vs. Western Electric case

The patentee, AT&T, granted a licence to Transformer Company to manufacture tubes for use in the field of home radios (consumer market), whilst retaining itself the right to exploit the patent, whether directly or indirectly, for use in the field of theatre applications (professional market). Transformer Company subsequently sold its products to General Talking Pictures. When one of the commercial licensees of AT&T found out that the theatre was using an amplifier system sold by a licensee who was licensed for consumer applications only, it sued for patent infringement.

Following the Supreme Court decision in *U.S. vs. General Electric* (272 US 476, 1926) that "it is well settled (...) that where a patentee makes the patented article and sells it, he can exercise no further control over what the purchaser may wish to do with the article after his purchase. It has passed beyond the scope of the patentee's rights. But the case is a different one (...) when we consider what a patentee who grants a license to one to make and vend the patented article may do in limiting the licensee in the exercise of the right to sell," the Supreme Court held that, since Transformer Company "could not convey to petitioner [General Talking Pictures] what both knew it was not authorized to sell," the Transformer Company infringed the patents embodied in the amplifiers by knowingly making the sales to petitioner outside the scope of its license, and GTP, having with knowledge of the facts bought at sales constituting infringement, did itself infringe the patents embodied in the amplifiers when it leased them for use as talking picture equipment in theatres.

The Mallinckrodt vs. Medipart case

The patentee, Mallinckrodt, manufactured medical devices which allows a radioactive mist to be breathed by a patient and then exhaled for purposes of diagnosing and treating pulmonary diseases. An essential part of this patented device was the nebulizer itself, filled by Mallinckrodt with the radioactive substance. Under its sales policy of the nebulizer units to hospitals, Mallinckrodt restricted the use of these units to a single application ("single use only"), after which they were to be discarded as medical waste.

Despite this restriction, some hospitals called upon the services of Medipart, that proposed to the hospitals to irradiate and clean the nebulizers, and to send the reconditioned units back to the hospitals for reuse, at a price three times less expensive than the supply of a new unit by Mallinckrodt. When Mallinckrodt found out about this practice, it sued Medipart for patent infringement.

Although the District Court held in favour of Medipart, on the basis that the first sale of the product by Mallinckrodt to the hospitals had exhausted the patent rights of Mallinckrodt, the Court of Appeal reversed, holding that "Unless the condition violates some other law or policy (...), private parties retain the freedom to contract concerning conditions of sale; (...) Should the restriction be found to be reasonably within the patent grant, i.e., that it relates to subject matter within the scope of the patent claims, that ends the inquiry. However, should such inquiry lead to the conclusion that there are anticompetitive effects extending beyond the patentee's statutory right to exclude, these effects do not automatically impeach the restriction. Anticompetitive effects that are not per se violations of law are reviewed in accordance with the rule of reason. (...) If the sale of the UltraVent was validly conditioned under the applicable law such as the law governing sales and licenses, and if the restriction on reuse was within the scope of the patent grant or otherwise justified, then violation of the restriction may be remedied by action for patent infringement."

It follows from these decisions that for as long as the contractual restriction is "within the scope of the patent grant or otherwise justified," and does not violate anti-trust or patent misuse provisions, the patentee cannot be said to have exhausted its patents rights when the products are resold in spite of the contractual restrictions (or prohibitions) attached to the license or the resale. The consequence of this case-law is that the patentee maintains a "long arm jurisdiction" on downstream purchasers of the product, whether or not these customers are aware of these restrictions.

If we break these decisions down to the core issues, three questions needs to be answered in order to determine how far the power of a patentee, confronted with a further commercialization of his products in disregard of his contractual rights, stretches: (1) when can a contractual restriction be said to be "within the scope of the patent grant," (2) when can a contractual restrictions be said to be "otherwise justified," and (3) even when both of the above mentioned conditions are fulfilled, can the contractual restrictions in all circumstances be invoked against a third party who was an outsider to this contractual arrangement?

With respect to the first and second question, it is highly likely that the European Court of Justice would reason along its established case-law according to which the exercise of a patent right is "within the scope of the patent grant" when the exercise is "justified for the purpose of safeguarding rights which constitute the specific subject matter of this property" (Centrafarm). It is also highly likely that the European Court would condemn any exercise of the patent right that is not "otherwise justified" when the intent would be to enforce contractual restrictions that violate article 81 of the EC Treaty—since the early Court's decision in Consten vs. Grundig (joined cases 56 and 58/64, judgment of the Court of 13 July 1966), it has been constantly held that the exception laid down in article 30 "does not allow the improper use of rights under any national trade-mark law in order to frustrate the community's law on cartels."

It is in particular in the 2009 Christian Dior decision that the European Court addresses these questions. Under the trademark license agreement that Christian Dior had concluded with SIL for the manufacture and sale of Christian Dior corsetry goods, it was stated that "in order to maintain the repute and prestige of the trademark the licensee agrees not to sell to wholesalers, buyers' collectives, discount stores, (...) without prior written agreement from the licensor." Despite this contractual restriction, SIL sold to Copad,* a discount store operator, certain consignments of goods.

Where Copad opposed the trademark infringement claim by invoking the exhaustion of rights as a result of the sale by SIL, the authorized licensee of Chistian Dior, to Copad, Christian Dior claimed that the sale was made in breach of the contractual obligations of SIL and thus, without the consent of Christian Dior.

Although the final outcome of the case is highly inspired by the trademark specifics laid down in Directive 89/104 and cannot be easily transposed to a patent license environment, the main consideration of the Court in this decision is that where a licensee puts goods on the market he must, as a rule, be considered to be doing so with the consent of the proprietor of the trademark; although the proprietor of the trademark cannot plead that the contract was wrongly implemented in order to invoke, in respect of the licensee, the rights conferred on him by the trademark, the fact remains that the license agreement does not constitute the absolute and unconditional consent of the proprietor of the trademark to the licensee putting the goods bearing the trademark on the market.

In other words, when we try to expose these considerations to the patent environment, where the contractual restrictions limit the scope of the license, any deed in violation of such restrictions may or may not lead to the exhaustion of the patent right. The desiderata of the European Court in the Christian Dior case, holding that the licensor could only invoke his trademark rights where the licensee contravenes

* The same Copad as the one represented in the Peak Holding case; for the purpose of the evolution of the exhaustion doctrine under European law, Copad may be considered the dignified successor of Centrafarm!

one of the provisions that are specifically listed in article 8(2) of the Directive, preludes that not all contractual restrictions in a patent license agreement will maintain the rights of the patentee to oppose his patent to any commercialization that is made in breach of the contract provisions. In particular, although the Court did not express this inasmuch, a contract restriction will only prevent the exhaustion of the property right when the disregard thereof may be considered to affect the essential function of the said right. For example, it is not likely that the European Court would consider that the patentee could "revitalize" its industrial property title against a licensee and his subsequent purchasers when, despite an "active sales" prohibition in the license agreement, the licensee organizes promotional campaign in a neighbouring country and temporarily increases his sales accordingly.

One exception to the rule that was already carved out by the European Court before it came to decide the Christian Dior case was defined in the Peak Holding case where the contractual restriction did not limit the scope of the license, but accompanied the sales of trademarked products by the proprietor to the purchaser. In the Peak Holding case, the contractual restriction consisted in the obligation upon Copad not to resell the products in European countries other than Slovenia and Russia. However, the European Court held that such contractual stipulations, part of the act of sale under which the goods are first put on the market, concern only the relation between the parties to that act; it cannot preclude the exhaustion provided for by the Trademark Directive. The conclusions of Advocate General Stix-Hackle are particularly illuminating. "Where the goods bearing the mark are put in the market by the trademark proprietor himself, exhaustion of rights arises by operation of law, irrespective of the contract between the proprietor and the purchaser. Breach of any territorial restrictions on sale which the proprietor may have imposed on a purchaser of the goods in relation to their sale may give rise to claims under the contract, but is irrelevant in principle under trademark law." Likewise, Advocate General Kokott in his conclusions on the Christian Dior case put the adagio as follows: "Contracts only bind the parties to that contract, whereas trademark rights and the exhaustion of such rights take effect in relation to everyone."

On the basis of the above decisions, one may therefore conclude that if the consent to sell is unconditional, the consent to license remains conditional, and may "mortgage" the subsequent sales of the licensed product when they are made in disrespect of the license agreement and the essential function of the patent right. A similar logic is applied under the U.S. approach to exhaustion. As noted by Richard H. Stern, "The Unobserved Demise of the Exhaustion Doctrine in U.S. Patent Law," 12 EIPR 1993: "Licenses create relational interests; sales create property rights." Thus, "violation of a condition in a license can be a patent infringement because the license authorizes the licensee to do something which would otherwise be patent infringement, and fails to authorize the licensee to do other things. (...) A sale, whether or not conditional, does not authorize customers to perform otherwise unauthorized acts; it conveys ownership." However, the Mallinckrodt–Medipart decision brought a serious blow to this classically accepted dichotomy where it considered that sales restrictions may likewise remain under the protective coverage of the patent rights for as long as they are within the scope of the patent grant or otherwise justified.

Although contractual restrictions that derive from the license agreement can thus in certain circumstances be opposed against a third party who was an outsider to this contractual arrangement, this conclusion is not an absolute one in that all decisions quoted contain certain exceptions to the rule. In the General Talking Pictures case, the Court held that no exhaustion took place because both the seller knew that the purchaser planned to use the amplifiers for fitting theatre equipment, and the purchaser knew that the licensee had no authority under its license to sell for such particular purpose; the Court did not give any indications on what would be its decision if, for example, the purchaser was unaware of the restrictive license conditions. In the Mallinckrodt–Madipart case, qualifying language was introduced with respect to the application of the antitrust rules. And the Christian Dior case limited the possible application of the trademark infringement suit against the third party to those acts that were explicitly listed in article 8(1) of the Trademarks Directive.

The conclusion that the patentee may contractually reserve its rights in order to prevent exhaustion is also contestable when we take a side-track to general principles of civil law. For instance, for any sale that is made in violation of pre-existing contractual obligations, the French Civil Code holds in favour of the purchaser when the latter acquired the products in good faith, in accordance with the cryptic rule of article 2279 Code Civil that "in matter of movables, possession is equivalent to a title" (meaning that he who purchases a good in good faith will be considered to have acquired ownership title of such good, even if the transferor did not have legitimate title to assign property with respect to that good). There is a certain logic to this stance, for if a proprietor (read: patentee) loans (read: licenses) an object (read: invention) to a person (read: licensee), and that person, although he holds the object under loan, sells that object to a third party in good faith, the rules of legal security and stability of commercial transactions want that property title vests in the third party, who did not know that the assignor did not have full authority to dispossess of the object; there is no reason why this should be different for license transactions where the licensee neglects the restrictive clauses of his license agreement. Article 1165 of the French Civil Code under which "agreements produce effect only between the contracting parties; they do not harm a third party" also points in this direction.

Another nail to the coffin seems to have been brought by the recent decision of the US Supreme Court in *Quanta Computer vs. LGE Electronics* (128 S. Ct. 2109, 2008), commented in the September 2008 issue of Les Nouvelles (John C. Paul a.o., "The US Supreme Court Clarifies Patent Exhaustion"). In this case, Intel was licensed by LG to make, sell and use microprocessors and chips under LG combination method patents, with the sole exception that no licence was included to authorize third parties (in particular Intel customers) to combine licensed Intel products with any non-Intel or non-LG products to make and assemble computers. Despite this license disclaimer and the notification thereof made by Intel to its customers, one of these customers, Quanta Computer, used the Intel products in combination with third party components to make and sell computer systems.

The US Supreme Court, essentially relying on its prior decision in *U.S. vs. Univis Lens* (316 US 241, 1942), held that, event though the licensed products sold by Intel did not infringe themselves any of the patent at issue (only the combination of those products did—but the answer would likely not have been any different if the licensed products themselves, as such, read on any of the patented claims), when the only reasonable use of said products were to practice the claims of the method patent, without any other alternative non-infringing use being reasonably possible, then the authorized sale of the item embodying the method exhausts the related method patent, irrespective of any contractual conditions to the contrary.

The setting of the cursor for the determination of the moment when consent can be deemed to have been given for the purpose of the application of the exhaustion theory will thus be paramount to industrial property right owners in construing their licensing policy and "contracting around exhaustion." It is not contested that a patentee may "chop up" its patent in various constituent value items in order to diversify its licensing strategy; for instance, a patentee may license its patent portfolio through a "flexible response" strategy towards its licensees by varying the scope of each license in accordance with the perceived strengths and weaknesses of its prospective licensees and their respective market positions and value capture potential, e.g. by means of territorial restrictions, product restrictions, field-of-use restrictions, etc. In each case, the consent to the sales that the licensee is authorized to make is qualified by the extent to which the patentee has restricted the scope of the license grant.

One example to illustrate such a strategy may the case of a patentee who, following a series of experiments carried out on samples from an oil wellbore suffering from asphaltene deposits, finds out that the use of hydrochloric acids reduces the potential of asphaltene formation, and applies for a patent on this invention (method patent). At the same time, the company has developed a particular chemical formula suitable to be used as an acid for injection into the well, in that this particular formula has limited corrosive effects (product patent). In order to commercialize its respective inventions, the company decides to enter into a two-tier licensing transaction, i.e. it intends to license the manufacture and sale of the chemical compound under its product patent claims to a chemical company, and it intends to license the application of the chemical compound in a wellbore under its method patent claims to interested oil and gas companies. Since the two patents do not cover exactly the same subject matter, the patentee does not provide for any restrictive clauses in its license agreement with the chemical company, but obliges the chemical company to give notice to its subsequent purchasers that the use of the chemical compound in wellbores remains subject to a further license to be concluded with the patentee (but the reasoning provided hereunder might apply likewise to a patentee having combined its inventions in one and the same "product-and-method" patent with a licensing policy structured around the grant of a license to manufacture and use to the chemical company, and a license to use to the oil and gas companies).

The business model defined by the patentee is to structure its licensing operations through the application of a "low value" royalty from the chemical manufacturer, whilst the bulk of the royalty is to be recovered from the operations where the "big bucks" reside, i.e. in the oilfield implementation. For instance, if the product is sold at a unit price of $50 but provides an economy to the oil operator of $1000, the licensor has every interest to focus his royalty extraction at the end of the value chain, and not at the beginning thereof. However, this business model could be easily frustrated if the oil and gas company could simply invoke the exhaustion of the patent right of the proprietor after he has legitimately acquired the chemical compound from the manufacturer–whether or not the latter has notified the company of the license restrictions under which the compounds are sold, because if the mere sale of the product, whose only effective use resides in its injection in an oil production well, exhausts the associated patent claims, notifying the customer of a retained right that no longer exists would be deprived of any legal sanction.

The Quanta decision leaves room to doubt whether the patentee can legitimately split the patent in two economic "sub-patents" where the right to manufacture and sell are licensed to one company and the right to use to another company, and whether he can continue to control his reserved rights on the use of the product once the latter has been sold by his designated licensee to a third party, when the product embodies all inventive features required for the subsequent use of that product. To put it simply, if the proof of the pudding is in the eating, once the pudding is sold to the customer, can you still prevent the customer from eating it? Cf. the US Supreme Court decision in *Adams vs. Burke*, 84 US 456-457 (1873): "But, in the essential nature of things, when the patentee... sells a machine or instrument *whose sole value is in its use*, he receives the consideration for its use and he parts with the right to restrict that use" (italics of the author).

Of course, this reasoning of the Supreme Court is only valid to the extent that the purchased product has no other reasonable non-infringing use. If the chemical compound would have other applications (e.g. for the elimination of rust), the patented application related to asphaltene prevention might well be invoked by the patentee. Likewise, if the patents do not purport to cover the same inventive subject matter, e.g. if the injection of the acid into the well necessitates the use of a machine with a special anti-corrosion coating developed by the patentee, the purchase of the machine would not thereby exhaust the method patent on the use of the chemical compound.

The Supreme Court also seemed to imply that the exhaustion might have been prevented if the license grant to Intel has explicitly excluded Intel's right to sell products to customers who later combine the licensed Intel products with non-Intel products downstream–the contract language used in the LG-Intel agreement was not sufficiently unambiguous on this issue. However, it remains doubtful whether the US Supreme Court would have relied on this contractual artifact as sufficiently compelling to change the outcome of the decision when Intel, despite the existence of this clause, would have sold to Quanta. Not only can Intel not anticipate, at the time of sale, to what particular use the purchaser, or his subsequent purchaser, will affect the components; but most of all, this clause would still bring about what the Supreme Court referred to as a possibility to "seriously undermine the exhaustion doctrine" because patentees could "simply draft their patent claims to describe a method rather than an apparatus," and thereby "shield practically any patented item from exhaustion."

It has been suggested in the September 2008 article in *les Nouvelles* that, "to be able to assert rights against a licensee's customer, the patent licensor may now need to have its licensee agree to less attractive business conditions up front;" for example, "the licensor can limit sales of components only to customers who are licensed by the licensor." Personally, I doubt whether this approach will pass the scrutiny of the antitrust or patent misuse rules, if the foregoing reasoning is consistently applied by the courts. Since the Supreme Court clearly condemns the "abuse" of one's patent right through the extraction of royalties at downstream license levels, when it can be established that the first licensed sale embodies all essential features of the patented invention, shifting the cursor contractually at an upstream license level by requiring the licensee to sell only to authorized clients (i.e. those having received a license to practice from the licensor) may be held to constitute an artificial restriction of trade or a misuse of the patent right, since it creates an artificial barrier to prevent the exhaustion of rights to otherwise legitimate business transactions. Where the US Supreme Court has already held that there cannot be indirect infringement in the absence of direct infringement (e.g. *Met-Coil Systems vs. Korners Unlimited*, 803 F.2d 684, Fed. Cir 1986), likewise there cannot be a valid patent license in the absence of a (non-exhausted) patent right. Consequently, the license agreement, even when concluded, may be considered null and void for lack of consideration. As for the EU Treaty, both article 81.1 §b ("limit or control production, markets, technical development, or investment") and 81.1 §e ("make the conclusion of contracts subject to acceptance by the other parties of supplementary obligations which, by their nature or according to commercial usage, have no connection with the subject of such contracts") are likely to provide cornerstones for an antitrust defence.

The exhaustion theory provides for a legal means of balancing the economic interests of the patent holder on the one hand, and the protection of consumer interests not to pay twice for the same invention on the other hand. I would like to add that the exhaustion theory should also be implemented in a way to protect the security of trade transactions of third parties, and that therefore the answer as to what should be the reserved space of the patent holder within which he can continue to oppose his patent rights against any third party that transgresses the rights that he intended to withhold within this reserved space, should be evaluated against the background of these respective interests. On the one hand, since patent rights convey property title, any sale not authorized by the patentee infringe the patentee's property right and it might then be said that whether the sale is made by a non-authorized third party (counterfeit manufacturer) or by an authorized third party under sales conditions that were not authorized, should not make any difference in order to conclude that there is infringement. But on the other hand, the security of trade transactions may compel that when a purchase is made from an authorized licensee, the risk that the sales are made under unauthorized conditions should rest with the patentee, who may use this breach by the licensee as a motive to terminate the agreement and claim for damages, rather than with the third party purchaser who acquired the product in good faith from an authorized source, unaware of the contractual restrictions imposed by the patentee.

Before we have a clear-cut decision on this intricate issue, it will be difficult for practitioners to provide waterproof advice, other than "playing it safe" and singularize the license deal at the end of the value chain (where the end-user may be authorized to sub-license the invention for the sole purpose of the manufacture of the patented product required for the particular intended use). For so long, there is no doubt that valid business objectives, recognized for example by the US Supreme Court in *Brulotte vs. Thys* (379 US 29, 1964) may be double-crossed by what courts may consider to be artificial patent constructions, paramount to "getting paid twice for the same invention." Despite the flaws of such legal reasoning, exemplified by John W. Schlicher in "The New Patent Exhaustion Doctrine of *Quanta vs. LG,*" *JPTOS,* November 2008, p. 783 ("If the product is a machine the buyer will use to make other products, the buyer captures the value of the machine when it sells the products made with the machine. The patent owner and the buyer may not know in advance of the machine sale how valuable the machine will prove to be to a particular potential buyer. To solve that problem, the patent owner may sell the machine at its manufacturing cost and license the buyer to use it and pay royalties based on a percentage of the buyer's revenue from sales of products made with the machine"), valid business objectives are often undermined by the workings of a common market where free circulation of products is favoured against market compartmentalization; a marketing system based on selective distribution suffers from the same detrimental consequences, as would be the case of any global market characterized by low value potential on the one hand and high value potential on the other hand.

Another area of interest relates to the assignment of patent rights to third parties, i.e. an asset deal where the patents are not licensed out to a third party but sold to a third party. Since patent rights are national rights, a patentee may decide to sell his patent rights registered in one country to a third party while retaining his patent rights registered in other countries. The reason for this patent split may be merely one of market analysis where the benefit of royalty revenues deriving from the patent rights in some countries is considered outweighed by the corresponding cost of maintaining and managing the latter. Instead of abandoning the patents, there may be an attractive market opportunity if an interested third party has expressed an intent to acquire these patent rights.

If this patent family split occurs, and the patent assignor and patent assignee have agreed on a reasonable price for the transfer of the patent rights registered in a given country A, can the patentee still oppose the subsequent importation of products manufactured in country A in all other countries where the patentee continues to hold himself the other members of the patent family? And reciprocally, can the assignee oppose his patent rights in country A in order to prevent imports of products originating from other countries where the patentee still holds the other patent members?

The European Court of Justice has had the opportunity to enter into this topic when the exhaustion of a trademark right was argued before the Court following an assignment by the French subsidiary of the Ideal Standard Company of its trademark homonym for heating equipment in France, within the framework of a global deal under which Ideal Standard France sold its entire heating equipment business unit to a third party, SGF (case C-9/93, *IHT vs. Ideal Standard*, judgment of the Court of 22 June 1994). When the assignee of the trademark for heating equipment started to sell the equipment under the Ideal Standard trademark to a German customer, IHT, the German subsidiary of Ideal Standard opposed its trademark that it continued to hold both on heating equipment and on sanitary fittings in order to oppose the importation of the heating equipment in Germany, on the grounds that the marketing of a product under the Ideal Standard trademark by a company not economically related to the Ideal Standard group would be liable to jeopardize the essential function of the trademark: consumers would no longer be able to identify for certain the origin of the marked goods and the proprietor of the trademark could be held responsible for the poor quality of goods for which he was in no way accountable.

The European Commission submitted that by assigning in France the trademark "Ideal Standard" for heating equipment to a third company, the American Standard group gave implied consent to that third company putting heating equipment into circulation in France bearing that trademark. Because of that implied consent, it should not be possible to prohibit the marketing in Germany of heating equipment bearing the assigned trademark.

Despite this consent of the trademark owner, the European Court of Justice held that "the consent implicit in any assignment is not the consent required for application of the doctrine of exhaustion of rights. For that, the owner of the right in the importing State must, directly or indirectly, be able to determine the products to which the trademark may be affixed in the exporting State and to control their quality. That power is lost if, by assignment, control over the trademark is surrendered to a third party having no economic link with the assignor." Consequently, it ruled that the trademark right of Ideal Standard was not exhausted in Germany and could be opposed by the German subsidiary of Ideal Standard.

Can we extrapolate this decision of the Court of Justice, given in a trademark context, to the area of patent rights? This is far from being certain. The trademark right in Germany was not exhausted because its essential function, i.e. the guarantee that all goods marketed under the trademark have been manufactured under the control of a single undertaking which is responsible for their quality, was not exhausted. However, the essential function of a patent is different from the essential function of a trademark in that the former is intended to create a "safe harbour" for the patentee only in order to reward the creative effort that he deployed under his R&D activities generating the invention; the inferior technical quality of the patented product, when the latter is manufactured by the assignee under different (less stringent) industrial production specifications, does not as such damage the value of the patent, although it cannot be denied that there may be a certain negative "overspill" effect on the overall product goodwill. However, if such negative effect arises, it is more likely to be associated with the identification bookmark of the product, i.e. the trademark under which the latter is marketed; the public at large is certainly not sufficiently acquainted with the technicalities of the patent in a way that it might be induced to believe that the inferior quality of the product manufactured by the assignee is attributable to the patent as such, thereby casting a doubt on the quality of all products (including those that are continued to be manufactured by the patentee) on a global scale.

Whether the patent is licensed out to a third party or assigned to a third party, in both cases will the patentee derive a reasonable reward from the operation: this will normally be under a "running royalty" formula for a license, and under a "capitalized royalty" formula for an outright assignment. The patentee may argue that the monetary valuation of the patent assignment only reflects the economic desiderata that compose the "monopoly value" of that patent for country A, and should not contaminate or dilute the residual "monopoly values" that remain attached to the other family members of the patent in other countries; and it may rely on the decision of the European Court in Ideal Standard that "since trade-mark rights are territorial, the function of the trademark is to be assessed by reference to a particular territory," extrapolating this same consideration to patent rights. But this argument is likely to be flawed since the essential function of a trademark, closely related to the identifying function of the trademark and the reputation and goodwill of the proprietor that it purports to protect, is very different from the essential function of the patent, which is to protect the financial interests of the proprietor and to avoid that third parties take a "free ride" on his invention. This essential function may be considered to have been fulfilled when, as the European Court acknowledged in the two Merck cases, the holder of the patent has freely decided, in the light of all the circumstances, the conditions under which he would market his invention; and once he has made this choice, "he must then accept the consequences of his choice as regards free movement of the product within the common market, this being a fundamental principle forming part of the legal and economic circumstances which the holder of the patent must take into account in determining how to exercise his exclusive right." The decision to assign the patent rights in a given country is, in that respect, not very different from a decision to grant a license in that country for a lump-sum royalty. The subsequent sales made by the assignee under the patent must then be considered to have been made with the consent of the patentee, and the corresponding products should be able to circulate freely throughout Europe.

The answer may be different when the assignment has been made under certain restrictive conditions, e.g. an obligation not to sell or cause the sale of the product in any country in which the assignor continues to hold a patent, accompanied with an obligation to explicitly label any product put on the market as being subject to export limitations. Whether these restrictions would prevent the patent rights of the patentee in all other countries to be exhausted remains, apart from the competition questions that such clauses may raise (cf. the decision of the European Court in Ideal Standard that "where undertakings independent of each other make trade-mark assignments following a market-sharing agreement, the prohibition of anti-competitive agreements under Article 85 applies and assignments which give effect to that agreement are consequently void"), subject to the considerations addressed here above.

Conclusions

Although this review of the exhaustion principles within the European Community is far from being exhaustive (for example, the review has been limited to an overview of patent issues only and does not address the issue of the international exhaustion of patent rights following the decision of the European Court of Justice in Silhouette), its purpose is to outline the many stumbling blocks that remain for intellectual property lawyers when confronted with the grand variety of trading transactions under which the patented products can cross borders and thereby contaminate the parallel patent rights that the patentee may hold in several countries.

First of all, despite a tendency that resurrects in the U.S. an approach to contract around exhaustion, whether through artful drafting of patent claims or contract clauses, it is far from certain that all such fabrics limiting the scope of the consent of the patentee, when disobeyed, prevent the patent from being exhausted. The European Court of Justice might also find that consent is established when the patentee has designated a licensee or a distributor for the manufacture and/or sale of his products, irrespective of whether the sales made by the licensee or the distributor respect the contractual conditions that set the framework within which the licensee or the distributor is authorized to sell–the essential function of a trademark which stood in the way of such a conclusion in the Christian Dior case has a larger bandwidth than the essential function of a patent which seems to be limited to financial considerations.

Second of all, the validity of these restrictive clauses should be evaluated against the background of the EC competition provisions. Since the object of the common market is to have one single market place without artificial boundaries, it has been held by the European Court of Justice that "by its very nature a clause prohibiting exports constitutes a restriction on competition, whether it is adopted at the instigation of the supplier or the customer" (case 19/77, Miller, judgment of the Court of February 1st, 1998). Unless the restrictive clause in question has been exempted, whether under one of the Block Exemptions issued by the European Commission or under a negative clearance or individual exemption, any clause between a patentee and his partners, whether they are licensees or distributors, tending to compartmentalize the respective markets, is likely to be held null and void. And in the absence of a valid clause determining the extent of the consent given by the patentee, the latter cannot reasonably invoke that the product was released on the market without his consent.

Since every solution should be a solution that reconciles at the same time the economic property interests of the patent holder and the economic security of business transactions pursued by trade operators, a possible recommendation may be to organize, like it is already the case for real estate property transaction, a public register where, if a patentee wishes to oppose his property reservations against third parties, a notarized extract of the patent agreement is filed with a list of caveats whereby the patentee provides formal notice of the restrictions attached to the license. The publicity of the registers provides for an easily accessible means to verify, like it would be the case for a real estate transaction, if any "mortgage" attaches to the product. Legitimate contract restrictions that enhance the value of the patent for different market applications may thus be recognized and upheld, while illegitimate restrictions that violate antitrust objectives or otherwise amount to a patent misuse may be simply ignored.

Nevertheless, to quote The Beatles in a concluding remark, it may still be a "long and winding road" before the issue of parallel imports and the exhaustion of rights by the patent proprietor has found an exhaustive doctrine. ■