

A new lease of life for “Euro-defences”

Overview

A Euro-defence is an argument that an intellectual property owner should be prevented from enforcing its rights against the defendant on the basis that to do so would contravene European competition law as set out in Articles 81 to 82 of the EC Treaty, or would offend against the principles of free movement of goods set out in Articles 28 to 30 of the EC Treaty and reflected in the rules regarding exhaustion of rights set out in, for example, Article 7 of Directive 89/104 and section 12 of the Trade Marks Act 1994 (the “Act”).

The English courts have long recognised that such defences are available in principle, but have often proved reluctant to entertain them in practice. The mere fact that a trade mark owner may be party to an agreement that contravenes Article 81 or that might partition the market in the EU contrary to Article 28 does not justify denying the proprietor any right to enforce its trade mark. There must be a sufficiently close nexus between the alleged contravention of the Treaty and the infringement claim to which that contravention is raised as a defence. Claimants have frequently succeeded in having Euro-defences struck out for want of such nexus.

Two recent decisions of the Court of Appeal indicate a shift in the courts’ attitude towards Euro-defences. While a sufficiently close nexus between the Euro-defence and the infringement

claim remains essential to the success of any such defence, it is now significantly more likely that Euro-defences will be permitted to be pleaded and tested at trial rather than being struck out or summarily dismissed at an early stage of proceedings.

MEQRs and exhaustion of rights

Articles 28 to 30 of the EC Treaty prohibit Member States from imposing any measure equivalent to a quantitative restriction (“MEQR”) on imports and exports, except where these measures may be justified for, among other things, the protection of intellectual property. One consequence of this prohibition is the doctrine of exhaustion of rights. Section 12(1) of the Act provides that a trade mark proprietor may not rely on its trade mark rights to prevent further dealings in branded goods put on the market in the EEA by that proprietor or with its consent. Save in certain limited circumstances, the brand owner cannot use its UK trade marks to prevent parallel imports from elsewhere in the EEA of goods bearing those marks.

However, this principle applies only if the UK trade mark owner consented to the marketing of those goods in the first place. The UK trade mark owner can prevent parallel imports if the goods in question were first marketed abroad by an unconnected entity. Since the decision of the European Court of Justice in *IHT Internationale Heiztechnik v Ideal Standard GmbH* [1994] E.C.R. I-2789, it

has been clear that this is the case even if the trade marks in different jurisdictions formerly belonged to an international portfolio of marks under common ownership. Whether that portfolio was divided voluntarily or otherwise, a subsequent brand owner’s rights will not be exhausted in respect of goods first marketed by another independent brand owner after that division of the portfolio.

Doncaster Pharmaceuticals – the limits to Ideal Standard

Until 2001, AstraZeneca (UK) Limited owned registrations in respect of the KALTEN trade mark for pharmaceutical products in Class 5 in a number of European jurisdictions. In 2001, the Spanish registrations were assigned to Teofarma Iberica SA and in 2004, the UK registration was assigned to Bolton Pharmaceutical Company. Doncaster Pharmaceuticals imported KALTEN capsules from Spain for sale in the UK. Bolton sued for trade mark infringement on the grounds that, following *Ideal Standard*, the imported goods could not be said to have been first marketed in the EEA with its consent and, consequently, its right to enforce the UK registration for KALTEN had not been exhausted in relation to those goods.

Doncaster argued in its defence that Bolton’s rights were, in fact, exhausted and that to permit Bolton to prevent the importation of genuine KALTEN capsules from Spain would amount to a

prohibited MEQR. Doncaster contended that, while there was no connection between Bolton and Teofarma, the assignments by AstraZeneca had been entered into in order to effect an artificial partitioning of the market for KALTEN capsules in the EU. Doncaster argued there was a continuing economic link between AstraZeneca and each of its assignees and that AstraZeneca had continuing rights to exercise a degree of control over its assignees' use of the KALTEN mark. Accordingly, the exhaustion principle should be applied, despite *Ideal Standard*.

At first instance, Terence Mowschenson QC, sitting as a deputy judge, gave summary judgment for Bolton. The deputy judge concluded there was no evidence supporting Doncaster's contention that Teofarma and Bolton were economically linked, or that the Spanish and UK registrations remained under the common control of AstraZeneca. He considered that the effect of *Ideal Standard* in these circumstances was clear and that Doncaster's defence had no real prospect of success.

The appeal in *Doncaster Pharmaceuticals*

On appeal, Doncaster emphasised that the assignments to Bolton and Teofarma had been accompanied by know-how licences and product agreements and that the assignments could be terminated if the assignee failed to pay the consideration due for the trade marks or in the event of the assignee's insolvency. The Court of Appeal was not persuaded that these points would be sufficient to demonstrate that the Spanish and UK trade marks remained under common control. However, the Court considered that Doncaster's defence raised issues demanding examination at trial and were not suitable for summary judgment.

In the Court's view, *Ideal Standard* did not comprehensively identify the situations

in which exhaustion of rights could be raised as a defence. That judgment did not establish that each and every voluntary assignment of marks would evade the principle of exhaustion. The circumstances in which the assignments to Teofarma and Bolton were made would require detailed examination to determine whether or not they were in fact made pursuant to a market-partitioning scheme which left ultimate control over use of the KALTEN trade marks in the hands of AstraZeneca. Certainly, the know-how licences and other agreements entered into alongside the assignments kept AstraZeneca "in the frame" as regards its assignees' use of the marks.

Accordingly, the Court concluded that Doncaster's defence could not be said to have no real prospect of success. The defence was therefore not suited to summary judgment and Doncaster's appeal was allowed.

Exhaustion of rights and "legitimate reasons"

Even where branded goods are placed on the market in the EEA with the consent of the trade mark owner, the principle of exhaustion of rights is qualified in certain circumstances. Section 12(2) of the Act (and Article 7(2) of the Directive) provides that rights are not exhausted if there are "legitimate reasons" for the trade mark owner to oppose further dealings in goods placed on the market in the EEA with the consent of that trade mark owner.

The principal examples of circumstances in which rights will not be exhausted (or, if once exhausted, will be revived) are those in which the condition of the goods has been altered after leaving the trade mark owner's control, or in which the packaging of the goods has been altered (whether by re-packaging, re-labelling or over-stickering) in a way that cannot be justified by the need to facilitate the free movement of goods within the EEA. In these circumstances, further dealings by third parties in goods

first marketed by the trade mark owner may be prevented as an infringement of the relevant marks.

More generally, a trade mark owner will have "legitimate reasons" to oppose further dealings if those dealings harm the trade mark in the requisite way. For these purposes, "harm" means having the consequences prohibited by section 10(3) of the Act, namely taking unfair advantage of, or causing detriment to, the distinctive character or repute of the trade mark.

Sportswear v Stonestyle

In *Sportswear v Stonestyle*, the claimant was the owner of the STONE ISLAND trade mark for, among other things, clothing in Class 25. Sportswear had entered into a number of distribution agreements and had appointed Four Marketing as its exclusive distributor for the UK, Eire and Iceland. Stonestyle acquired STONE ISLAND branded clothing from an Italian supplier and imported that clothing into the UK for sale.

In this case, there was no doubt that the clothing imported by Stonestyle had originally been put on the market in the EEA with Sportswear's consent. The articles were genuine and Sportswear owned the STONE ISLAND mark throughout Europe. However, Sportswear's STONE ISLAND mark appeared on the labels of its products together with a garment code that enabled Sportswear to identify for which of its distributors each product had been made. Sportswear stated that the purpose of the garment codes was to enable it to distinguish between genuine and counterfeit goods and to assist in the administration of its business. These garment codes had been removed from the goods imported by Stonestyle.

Removal of garment codes – legitimate reasons?

Sportswear argued that, by removing these codes, Stonestyle or its supplier had altered the condition of the goods or

their packaging and had caused damage to the reputation or distinctiveness of the STONE ISLAND mark. Accordingly, Sportswear contended that it had legitimate reasons to oppose further trade in those goods. Therefore, its right to enforce the STONE ISLAND trade mark in respect of the imported goods had not been exhausted and Stonestyle's imports infringed its UK registrations.

Stonestyle denied its conduct could amount to infringement. Stonestyle argued that the removal of the garment codes was incapable of providing "legitimate reasons" for the purposes of section 12(2) of the Act. The codes were not used, as Sportswear contended, for largely administrative purposes. Rather, argued Stonestyle, the codes were intended to enable Sportswear to ensure that goods originally made for sale in one distributor's territory did not find their way into other markets.

According to Stonestyle, the garment codes were tools for giving effect to the exclusivity arrangements in the distribution agreement between Sportswear and Four Marketing (and to any equivalent arrangements in Sportswear's agreements with its other distributors). The codes were used to give effect to provisions of the distribution agreement that were intended to partition the market in the EEA and prevent, restrict or distort competition within the common market. These provisions were therefore unlawful under Article 81 of the EC Treaty and Sportswear could not rely on the avoidance of measures taken to implement those provisions to justify enforcing its trade mark rights against Stonestyle.

Breach of Article 81 may undermine "legitimate reasons"

Sportswear applied to have this argument struck out from Stonestyle's defence on the grounds that it did not disclose any defence capable of succeeding in law. For the purposes of the striking out application, it was assumed that the

relevant provisions in the distribution agreements were in breach of Article 81. Sportswear argued that, even on this assumption, there was no sufficient nexus between that alleged breach of Article 81 and its claim for trade mark infringement. Stonestyle did not deny that a sufficient nexus was required, but pointed to the judgment in *Frits Loendersloot v George Ballantine & Sons Ltd* [1997] ECR 6227, in which the European Court of Justice held that:

Where it is established that ... identification numbers have been applied for purposes which are legitimate from the point of view of Community law, but are also used by the trade mark owner to enable him to detect weaknesses in his sales organization and thus combat parallel trade in his products, it is under the Treaty provisions on competition that those engaged in parallel trade should seek protection against action of the latter type.

Stonestyle argued that this meant it was entitled to raise Sportswear's alleged breach of Article 81 as a defence to the trade mark infringement claim. Sportswear contended that this was a misreading of the *Loendersloot* decision and that Article 81 provided Stonestyle with a sword but no shield. While Stonestyle was entitled to refer Sportswear's alleged breach of Article 81 to the European Commission, that breach could not form the basis of a defence to infringement.

Sportswear also argued that any contravention of Article 81 was irrelevant to the infringement case. If the removal of the garment codes did not damage the STONE ISLAND trade mark, then Sportswear would not be able to rely on section 12(2) of the Act in any case (since such harm is a prerequisite for there to be "legitimate reasons" to oppose trade in the goods) and Stonestyle would escape liability for infringement. However, if the removal of those codes did damage the trade

mark in the necessary manner, then the Article 81 argument would be bound to fail as a defence, because that damage would mean that Sportswear had legitimate reasons to enforce its trade marks against Stonestyle irrespective of the terms or effect of any agreement to which it might be party.

At first instance, Warren J had accepted Sportswear's arguments and ordered that the relevant parts of Stonestyle's defence be struck out. The Court of Appeal disagreed. The Court considered it was unclear whether a breach of Article 81 provided a shield as well as a sword, but concluded it was "well arguable" that a defendant would have a stronger basis for defending an infringement claim if it could be shown that the trade mark owner was party to relevant agreements that contravened Article 81.

Moreover, the Court concluded it was "an open question" whether the effect of any such breach would be to provide a defence to an infringement claim even where the defendant's actions had damaged the trade mark in a way that would otherwise have given the trade mark owner legitimate reasons to oppose further dealings in the goods in question. The Article 81 defence raised by Stonestyle was therefore not redundant. Although the Article 81 argument would be unnecessary if Sportswear could not establish that its trade mark had been damaged in the requisite manner, it could not be said that the defence would necessarily fail if Sportswear could prove that its trade mark had been so damaged.

The Court held that Stonestyle's Euro-defence was sufficiently arguable (and had a sufficiently close nexus to the infringement claim) that it could not be struck out.

Euro-defences after *Doncaster Pharmaceuticals* and *Sportswear*

The decisions in *Doncaster Pharmaceuticals* and *Sportswear* indicate

that the courts may be increasingly receptive to Euro-defences to intellectual property infringement claims. Moreover, in *Doncaster Pharmaceuticals*, Longmore LJ stated that the law relating to exhaustion of rights and to MEQRs more generally is "still in the process of formulation" and that "summary disposition is not appropriate in what is a developing area of law". Longmore LJ regarded the decision in *Sportswear* as also demonstrating that Euro-defences should not be summarily dismissed or struck out while the relevant law is in flux. For Longmore LJ, the decisions in these cases should clearly be taken by the lower courts as encouragement to allow Euro-defences to proceed to trial.

Similarly, while Mummery LJ in *Doncaster Pharmaceuticals* warned against allowing defendants to over-complicate matters simply in order to avoid summary judgment, he also said the court must be wary of "the cocky claimant" who "presents the factual and legal issues as simpler and easier than they are". The Court of Appeal has, in short, given a strong indication that defendants should be given the opportunity to make out their Euro-defences at trial. Whether such defences will often ultimately succeed is as yet unclear, but defendants are likely to be more inclined to run a Euro-defence.

Further where parallel imports are in issue, the contractual arrangements relating to both the products and the marks are likely to come under scrutiny. Following *Doncaster Pharmaceuticals*, where marks were formerly under common ownership any relevant assignments are likely to be scrutinised for signs either of a continuing relationship between the assignees and the former owner or between the

assignees themselves. The less "clean" the disposal of the marks – the less like a bare assignment the transaction appears to have been – the more likely it is that a defendant importer will be able to mount a defence based on exhaustion of rights, notwithstanding the principles set out by the ECJ in *Ideal Standard*. Similarly, following *Sportswear*, defendants responsible for any form of re-packaging or re-labelling can be expected to demand a close examination of any agreements between the trade mark owner and its distributors or licensees that may have dictated the appearance of the original packaging to determine whether that original packaging was devised with a view to prevent the free movement of goods across borders within the EU.

Perhaps the strongest indication of the Court of Appeal's current receptiveness to Euro-defences is the following comment by Mummery LJ in *Doncaster Pharmaceuticals*:

According to Bolton, the assignments by [AstraZeneca] to Teofarma and Bolton have put Bolton, as assignee of the mark in the UK, in a better and stronger position than [AstraZeneca], the assignor, was in relation to the enforcement of the UK trade mark against Doncaster. This is difficult to square with the general rule that an assignee steps into the shoes of the assignor and, in law, is in no different position than the assignor was.

Longmore LJ agreed, observing that it would "be a little surprising if an assignor can, by assignment, convey more rights than he himself has".

This reasoning is unpersuasive. Trade mark rights are always territorial and, but for the free movement provisions of the

EC Treaty, would entitle any trade mark owner to prevent imports of branded goods. Article 30 recognises that the protection of intellectual property may justify a derogation from the principle of free movement, even in the context of a common market. The doctrine of exhaustion then holds that such derogation cannot be justified where the use of a particular mark in different jurisdictions is under common control. This is a limitation on the enforcement of rights that arises due to the assignor's particular circumstances. By assigning its marks in different territories to different assignees, an assignor does not convey rights that it did not hold; it merely passes those rights free of the limitations imposed on it by the principle of exhaustion.

Nevertheless, Mummery LJ's remarks seem to indicate a dissatisfaction with the *Ideal Standard* principles as currently understood. If so, Euro-defences wider than that put forward in *Doncaster Pharmaceuticals* may have some prospect of success. Assignees of part of a trade mark portfolio may in due course find enforcement of their acquired rights more problematic than they anticipated.

(*Sportswear SpA and Four Marketing Limited v Stonestyle Limited* [2006] EWCA Civ 380, Court of Appeal (Waller, Longmore and Lloyd LJ), 11 April 2006; *Doncaster Pharmaceuticals Group Limited and others v The Bolton Pharmaceutical Company 100 Limited* [2006] EWCA Civ 661, Court of Appeal (Mummery and Longmore LJ and Lewison J), 26 May 2006)

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