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Branded Bits –
Trademark Exhaustion in Internet Trade
from an EC-law Perspective

Master Thesis
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"Railroads hauled the tangible goods of the industrial age. Being made of atoms, they were hard to replicate and transport but trivial to buy, sell and own. Railroads naturally concentrated on what was the harder part of the problem and left the trivial problem of buying and selling them to the merchants at each end of the line. With goods made of bits, we've exactly the opposite problem. Its trivial to transport them but very hard to buy, sell and own them."

Brad J. Cox *"Superdistribution: Objects as Property on the Electronic Frontier"*
Addison-Wesley Pub Co., 1996

“The whole idea of free enterprise, as we understand it in this country, is based on the importance of the identity and personal responsibility of the producer for the goods he sells, which are evidenced by his trademarks, names and brands. If that is the sort of an economy we are to have in this country – and I sincerely hope it is, because we have had it for a good many years and it has worked – then trade-marks and brands should be protected so that an incentive will be given to all manufacturers to produce the best goods they know how and take pride in them – and not merely comply with minimum government specifications. You can't have competition unless you can distinguish between the competing goods and choose between them. Trade-marks make this distinction and this choice possible. Without them there could be none.”

Rogers, *"The Lanham Act and the Social Function of Trade-marks"*, 154 *Law and Contemporary Problems*, 180 (1949)

1 Introduction

The quickly increasing use of the Internet is changing the environment in which our laws are to be applied. Thus, in many cases either the application of the laws has to be changed, or the laws themselves have to change.¹ The purpose of this thesis is to discuss how the EC-law on trademark exhaustion is to be applied in the new legal environment provided by the Internet. Both trade in tangible and digital products will be discussed. Regarding digital products it will be examined both from a theoretical and practical viewpoint, whether, and to what extent, the trademark rights of such products become exhausted when they are sold.

The principle of trademark exhaustion means, in short, that a trademark proprietor's exclusive right to use his trademark at the marketing of a good is exclusive only until the good in question has been put into circulation on the market. After the sale, everyone that has bought the good has the right to use that trademark when making subsequent sales. Without the exhaustion principle, it would be much harder to sell goods in second hand, since they then would have to be sold without its trademark.

1.1 Scope of the Thesis

This thesis focuses on the problem of trademark exhaustion only, thus leaving copyright exhaustion and other kinds of intellectual and industrial property exhaustion aside. This might be regarded as a weakness of the thesis, as the trademark aspect in most cases will not suffice when the distribution rights to a product is to be established. However, it has not been possible to include the other aspects, as that would have forced the discussion to be too superficial. It is more interesting to examine one aspect in higher detail. In the examination of the EC-law exhaustion principle and its application on the Internet, this thesis will focus on parallel trade, as that is more economically significant than single second hand transfers of goods. However, single second hand transfers will not be neglected.

Nor will the EEA-treaty be discussed. That treaty establishes a trade union between the EU, Norway and Iceland, which, among many other things, extends EU trademark exhaustion to the mentioned countries.² There are certain discrepancies between the application of the exhaustion principle in the EU and the EEA, which only would complicate the discussion.³

¹ Joachim Benno, "Transaktionens anonymisering och dess påverkan på rättsliga problemställningar – En teori om varför rättsliga problem uppstår vid användningen av IT" in "Elektronisk handel - rättsliga aspekter", Nordisk årsbok i rättsinformatik 1997, red. Randi Punsvik, especially p. 71-75.

² The EU trademark directive is valid also in the EEA. Further, the principles evolved by the ECJ regarding exhaustion of intellectual and industrial property rights are valid also in the EEA. See article 2, protocol 28 to the EEA-treaty.

³ For a discussion on the discrepancies, see Hans Henrik Lidgaard, "Regional konsumtion i EU hindrar parallelimport från lågprisländer", ERT 1998 p. 40-43. The discrepancies shows for example when comparing the ECJ case *Silhouette International Schmied GmbH & Co. KG v. Hartlauer Handelsgesellschaft mbH*, Case C-355/96, 16.7.98 (not yet published; hereafter *Silhouette*) with the EFTA Court advisory opinion *Case E-2/97, Mag Instrument Inc. v California Trading Company Norway*, Ulsten, 3 December 1997. Although both courts applied article 7.1 of the EU trademark

This thesis will not get into the question of *conflict of laws*, although that question is very significant for a practical analysis of Internet trade. *Conflict of laws* is a legal area clearly separated on a theoretical level from trademark exhaustion, and as it is a comparatively complex area, it deserves an analysis of its own, which can not be made here.⁴

1.2 Literature

There exists both a rich literature on trademark exhaustion according to EC-law, and on different legal aspects of the Internet and its trade. In these areas, it has been more problematic to pick the best texts than to find relevant literature. However, the problem of trademark exhaustion on the Internet has scarcely been addressed in the legal doctrine. The problem of unauthorized distribution of digital products is most often analyzed from a copyright view, which makes that literature of lesser interest for this thesis. The use of trademarks on the Internet is discussed in the legal doctrine, but then mostly regarding their use on web-sites and in domain names, problems that are of lesser interest for the purpose of this thesis.⁵

In those cases a material is found solely on the Internet, a web-address will be given as reference, together with the date on which the material was accessed.

1.3 Method

The disposition of this thesis will be as following: After some basic remarks about trademarks and their functions, the European Court of Justice (ECJ) case law on trademark exhaustion will be examined. Thereafter, examples of trade on the Internet in both tangible and intangible products will be given, and the characteristics of intangible products will be examined. Finally, the exhaustion doctrine will be applied on Internet trade.

The principle of exhaustion is easily applied on Internet trade in tangible products, as such trade is similar to for example catalogue shopping. On the other hand, it does not seem to be equally sure how the exhaustion principle should be applied on trade in intangible, digital, products. Despite that the Internet is rapidly evolving as an important marketplace, the differences between tangible and digital products, and between traditional trade and digital trade have not yet been sorted out sufficiently. Today in many fields we have a situation in which the existing rules does not fit the new legal situation, while new ones not yet have been adopted. This calls for a creative use of the existing rules, so that the Internet will not be left unregulated.⁶

directive, they arrived at opposite conclusions. Further, the EEA-treaty only covers goods originating from the EEA, while the EC-treaty covers all goods in circulation on the common market.

⁴ See for example Thomas Carlén-Wendels "*Nätjuridik – Lag och rätt på Internet*" p. 37-51, or Richard Åkerman and Åsa Thunman "*Jurisdiktion- och lagvalsproblem på Internet*" JT 1997-1998 p. 432-477.

⁵ See for example EIPR, which during the last few years has published a number of articles on both of the mentioned topics, but none on trademark aspects of digital distributions.

⁶ For an argumentation in support of this view see Joachim Benno, "*Transaktionens anonymisering och dess påverkan på rättsliga problemställningar – En teori om varför rättsliga problem uppstår vid användningen av IT*". Benno describes how the Internet is changing the legal environment, and he argues that the changes are making many recent laws and rules impracticable. To cope with the changes, one should focus on the functions of the rules, and the purposes that they are set to fulfill.

When discussing legal solutions for the Internet, the focus should be had on the functions and purposes of the rules in question.⁷ It is the aim of this thesis to keep that in focus. Accordingly, if the trademark exhaustion fulfils the same or comparable functions in digital trade as it does in traditional trade, it should be possible, in the view of the author of this thesis, to apply it also on this new phenomenon. Or to put differently – if digital products are traded with in the same way as traditional goods, or at least in a comparable way – then the rules from the physical world could be kept.

Towards the end of this thesis, the author will discuss a few possible ways to solve some legal problems. It should then be kept in mind that this thesis does not intend to present any final solutions. The conclusions arrived at should rather be read as proposals of possible ways to understand the legal problems in question.

1.4 The Amsterdam Treaty

The first of May 1999 the Amsterdam treaty went into force. It amends the EC-treaty, however, not in the intellectual and industrial property area. Through the Amsterdam treaty, the articles of the EC-treaty are renumbered. As case law and doctrine produced before that date are referring to old article numbers, they will be indicated within square brackets after the current article numbers. For example, article 28 of the EC-treaty, which earlier was numbered article 30, will be referred to as article 28 [30]. When nothing else is mentioned, articles referred to are found in the EC-treaty.

2 The Internet and Digital Products

2.1 The Internet⁸

The Internet can be described as a "global matrix of interconnected computer networks using the Internet Protocol (IP) to communicate with each other." In this paper, the term "Internet" will be used to encompass all such data networks with their different applications, e.g. the World Wide Web, e-mail etc that run on those networks. Some of these networks may technically not be a part of the Internet, but that is irrelevant for the purpose of this thesis.⁹

The computer network that later became the Internet was invented in the late 1960's in the United States, but it did not reach out to a larger audience until the 1990's. Today hundreds of million people throughout the world are using the Internet for different purposes.¹⁰ In 1994, the first shopping mall on Internet arrived,¹¹ and since then, consumer oriented Internet trade has been growing quickly.

⁷ Benno, *ibid.* p. 72.

⁸ The history of Internet and a few remarks about its technology is described in the appendix.

⁹ This is a definition of the Internet used in "*The Emerging Digital Economy*", a US-government report published in April 1998, p. 1. See www.ecommerce.gov/ (17.5.99).

¹⁰ In Sweden, nearly half of the adult population used the Internet during April 1999. This according to the research institute Sifo, www.sifointeractive.com/. (17.5.99)

¹¹ Robert Zakon, "*Hobbe's Internet Timeline*", www.isoc.org/zakon/Internet/History/HIT.html (17.5.99)

2.2 Are Digital Products Goods or Services?

It seems to be not yet established whether digital products should be regarded as goods or services. As some rules are applicable on goods, while others on services, legal consequences follow with the classification. The doctrine of trademark exhaustion has evolved around traditional commerce in tangible goods, mostly parallel trade. Services, on the other hand, can not be traded with in second hand. However, as trade moves over to the Internet, the classification of a product as a good or a service becomes less clear. The Commission for example, regards all digital products as services.¹² This view can be critiqued. Many digital products, as for example software deliveries or digitized books or music in many ways resembles of goods.¹³ Other products, like web-mail services, electronic newsletters etc are recognizable as services. However, for the purpose of this thesis, it does not seem to be necessary to take sides in this the discussion whether digital products can be classified as goods. If a functional view on the exhaustion principle is taken, it does not matter what the products in question are called or classified as, as long as trade in them on relevant points is comparable with trade in tangible goods. Thus, it is the view of the author that the EU's classification of digital products as services should not hinder the application of the exhaustion doctrine.

3 Some Remarks on Trademarks

3.1 Territoriality and Independence

Trademark rights are territorial, which means that the right to a certain mark is valid only in a country where the mark has been registered or is otherwise protected. The protection is differently shaped in different states, which can cause problems for international trade, but many of these problems are coped with through international treaties making the rules more uniform. However, despite of a history of more than hundred years of broad international treaties harmonizing trademark laws, there is no international rule on how to handle exhaustion of trademark rights.^{14 15}

Trademarks in different countries are independent of each other, which means that a trademark registered or otherwise protected in one country is not affected by changes to trademarks in other countries. The owner of a trademark that is parallel registered in more than one state could for example sell off his rights in some countries without having to accept any changes in the protection in those countries where he is keeping

¹² The Commission has in November 1998 proposed a directive on certain legal aspects of electronic commerce in the internal market, whose legal basis is the EC-treaty chapter on services, not the chapter on trade restrictions, (COM (1998) 586 final). This view of the Commission is further expressed in the amended proposal for a directive on the harmonization of certain aspects of copyright and related rights in the information society, (COM (1999) 250 final), whose 19:th recital states that the question of exhaustion does not arise at all in case of on-line services. This view is also expressed in the Commission's communication "*Electronic Commerce and Indirect Taxation*" p. 5 (COM (1998) 374 final).

¹³ Eva Fernquist "*Köplagens tillämpning på handel med digitala produkter*" section 2.2., published at cent.hgus.gu.se/law/research.htm at Christina Hultmark's section. (17.5.99)

¹⁴ Koktvedgaard/Levin, "*Lärobok i immaterialrätt*", p. 296-297.

¹⁵ Compare for an example TRIPS, article 6, in which in which the treaty explicitly refrains from regulating exhaustion of industrial or intellectual property.

the trademark.¹⁶ However, in the EU, there are two trademark regimens that are tied to more than one state. The trade mark laws of Belgium, the Netherlands and Luxembourg are merged into one single law with a common court, and the EU itself has in 1995 introduced a common European trademark valid all over the union.¹⁷

3.2 EC-law and Territoriality of Trademarks

One of the essential goals of the EU is to provide an internal market without trade restrictions.¹⁸ However, as trademark protection is nationally regulated, trademark laws tend to have effects that restrict trade between states. When two trademarks, so similar that they are likely to be confused with each other, are protected in different parts of the common market, a product bearing one of those trademarks might be impossible to export within the EU. This is because the company in member state A would infringe upon the trademark rights of the company in member state B if it would market its goods there under the similar trademark. Such trade restrictions are protected by community law.¹⁹ However, the territoriality of trademarks, left unchecked, could be an instrument in the hands of companies to protect their sales from competition. That would be the case if a company could, on grounds of protection of its trademark, oppose the importation of products it itself had put on the market in another member state. That would raise the trade borders between the member states.²⁰ This is not the case in the EU today, thanks to the EC-treaty, as it has acknowledged the risk of partitioning of the common market on grounds of trademark protection.

If we turn to the rules of the treaty, article 30 [36] allows a member state to restrict trade between itself and another member state on grounds of the protection of industrial and commercial property, of which trademark protection is a part. Furthermore, in article 295 [222], the treaty constitutes that it in no way shall prejudice the rules in the member states governing the system of property ownership. This article has been interpreted by the ECJ to protect national rules on industrial and intellectual property. However, the treaty also offers three ways to cope with this risk of partitioning of the common market.²¹

- Although that article 30 [36] constitutes that the protection of industrial and commercial property are justified grounds for a member state to restrict importation from another member state, the article also prohibits the use of this rule if it would constitute a means of arbitrary discrimination or disguised

¹⁶ The principle of independence is laid down in the Paris Union Convention of 1883 for the protection of industrial property. The principle was important for the outcome of the Ideal-Standard case of the ECJ, para 24-29, see below in section 4.4.4.

¹⁷ Regulation 40/94/EG

¹⁸ Articles 3 [3] and 28-31 [30-37] of the EC-treaty.

¹⁹ Carl Michael Quitzow “*Fria varurörelser i den europeiska gemenskapen. En studie av gränsdragningen mellan gemenskapsangelägenheter och nationella angelägenheter*” p. 283. See also the case *Societe Terrapin (Overseas) Ltd. v. Societe Terranova Industrie CA Kapferer & Co.*, Case 119/75, 22.6.76, [1976] ECR 1039.

²⁰ See section 3.3, in which the concept of branding is described more thoroughly. See also Hans Henrik Lidgaard, “*Regional konsumtion i EU hindrar parallelimport från lågprisländer*”, p. 31-32.

²¹ Beutler/Biber/Pipkorn/Streil, “*Die Europäische Union*”, p. 301-302.

restriction on trade between the member states. The ECJ has developed a broad case law on this rule, which extensively clarifies how far a member state may go.²²

- Art. 81.1 [85.1] protects the common market against cartels that may affect trade between member states. Such cartels can be constructed with trademarks, as two companies can partition the market between themselves by the use of the territoriality of trademark rights.²³ Cartels affecting trade between member states will according to 81.2 [85.2] often have to be regarded as void.²⁴
- The harmonization of the laws of the member states can be used to diminish the legal differences between the member states – and thereby the hindrances to trade. In 1989, a directive on the harmonization of trademarks for goods and services was introduced. The directive addresses, among other things, which rights can be derived from a trademark, and how the principle of exhaustion is to be shaped. In 1995, a common EC trademark for goods and services was introduced through a regulation, through which it became possible to get identical trademark protection throughout the entire EU.²⁵

These instruments have proven successful, and the risk of partitioning of the common market expressed above has not been realized. Through the interpretation of article 30 [36], the ECJ introduced the principle of trademark exhaustion into the EC-law, and through the trademark directive, it was codified.²⁶ According to the principle, trademarks put on the common market are exhausted within the EU. Without this harmonization of laws some of the member states would perhaps have kept a narrower interpretation of the exhaustion principle, meaning that they would have regarded a trademark as exhausted only if it had been put for sale on the domestic market.²⁷

The EU's policy on trademark exhaustion towards other countries is not to the same extent aimed at the removal of trade restrictions. It has always been possible for a member state to stop the importation of goods from markets outside the common market on grounds of trademark protection, even if the company protesting against the importation had sold the trademarked goods itself. It was, however, for a long period of time also possible for the member states to, instead of that, choose to apply international exhaustion of trademark rights, meaning that a trademark should be exhausted when the goods in question has been sold on world market. Then, in 1998,

²² Beutler/Biber/Pipkorn/Streil, *ibid* p. 302-303. See also for example Quitzow “*Fria varurörelser i den europeiska gemenskapen. En studie av gränsdragningen mellan gemenskapsangelägenheter och nationella angelägenheter*” p.271-289 for a thorough examination of the case law regarding industrial and intellectual property.

²³ The simply use the same trademark in their respective countries, as they then can hinder any importation of the product of the competitor. Such a practice can be useful for both companies, as they both gain from lesser competition.

²⁴ Beutler/Biber/Pipkorn/Streil, “*Die Europäische Union*”, p. 302. See also Albert Bleckmann “*Europarecht*” p. 691-694 for an examination of the EC-law on competition control and intellectual and industrial property.

²⁵ Directive 89/104/EEG and Regulation 40/94/EG. Beutler/Biber/Pipkorn/Streil, “*Die Europäische Union*”, p. 302.

²⁶ Article 7 of the directive.

²⁷ See Quitzow, “*Fria varurörelser i den europeiska gemenskapen. En studie av gränsdragningen mellan gemenskapsangelägenheter och nationella angelägenheter*”, p. 271-289 which shows how many cases has been needed to shape the exhaustion doctrine.

the ECJ closed that possibility, as it in the Silhouette judgement established that the member states should apply EU-wide exhaustion only.²⁸

3.3 Functions and Usage of Trademarks

Trademarks are today increasingly important as instruments to connect between customers and the commercial origin of a product. The commercial origin of a product should not be confused with its actual origin. It is today common practice that products stemming from different manufacturers are marked with the same brand, and that products from one manufacturer are sold under different brands. The function to identify the commercial origin of a product is especially important for the consumer, for whom it serves as a guarantee of its quality. There is no legal guarantee that the producers will keep an even quality, but as trademark owners in most cases are depending on loyal customers, they are likely to keep it on that ground.²⁹

From the trademark owner's point of view, an advertising function can be identified – every time a brand is viewed the viewer will be reminded of the product, and maybe triggered to buy it. That is a function related to the market-steering function of trademarks. Products from different producers are often very similar to each other in quality and design, which leaves the customer with only the trademark as guidance for his choice.³⁰ To make its customers more loyal, trademark owners are trying to make their trademarks as strong as possible, by building strong identities around them, connecting them with a certain lifestyle, a process called “branding”. The importance of strong trademarks is accentuated on Internet trade, as customers shopping on the net have no other guarantee for the quality of the product than the brand. The customer has for example no opportunity to physically examine the product before the purchase.³¹ Branding tends to be profitable for trademark holders, as many customers are willing to pay comparatively high prices for products labelled with the strongest brands, irrespective of that other products might be of better quality. Examples of successfully branded trademarks are Coca-Cola, Levi’s and Tommy Hilfiger. The goal is of course to get as much revenue as possible from the marketing of the product, and with a strong trademark measures like price differentiations and differentiation in quality between countries, dumping of excessive stocks on low price markets etc becomes possible. This development is, however, counteracted by the increasing international trade in branded products. There exists a conflict of interests on this point between trademark holders, that wants to maximize their profits, and persons trading branded goods in second hand, from low-price markets to high-price markets. These traders, taking advantage of the price differences, are called “parallel traders”. They re-import goods that are dumped abroad, they parallel-import goods that is cheaper on its home market than in the importing country, and they side-import foreign goods similar to goods produced in the importing country. It is obvious that parallel trade is likely to obstruct branding, for example as it undermines the

²⁸ Hans Henrik Lidgaard “*Regional konsumtion i EU hindrar parallelimport från lågprisländer*”, p. 37-40 and 46-47.

²⁹ Marianne Levin, “*En ny nordisk känneteckensrätt inför 2000-talet*”, NIR 1994, p. 519 ff.

³⁰ Marianne Levin, *ibid*, p. 519 ff.

³¹ Lennart Forsebäck, “*Cybershoppare, intermediärer & digitala handelsmän - elektronisk handel i ett hushållsperspektiv*”, Teldok 120, p. 89, see also Weje Sandén, “*Nätet som marknadsplats - De svenska pionjärerna*”, Teldok 123, p. 150.

trademark owner's market in high-price countries. The customers are simply likely to make their purchases from the cheapest source.³²

3.3.1 The Development at the ECJ

During the last decades, the ECJ has significantly changed its view on trademarks. In the 1970's, the Court expressed a low valuation of trademark rights, for example in the Sirena case, in which it regarded them as no more than just another obstacle to the free movement of goods.³³ In 1990, however, in the HAG II case, the Court found trademarks "an essential element in the system of undistorted competition which the treaty seeks to establish and maintain."³⁴ The ECJ has several times put forward the importance of the trademark's function to guarantee the origin of a product. By providing certainty for the customer or end user that the product in question has not been subject to any interference by a third party, the product's original condition is guaranteed.³⁵ As mentioned above, this is not directly a protection of good quality, but rather a protection of the quality that the owner of the trademark chooses for his products.³⁶ However, in Silhouette in 1998, the Court contributed to the weakening of the origin function, as it confirmed the principle of regional trademark exhaustion. Regional exhaustion does not take aim at the commercial origin of a product if it was not marketed within the community. It rather seems to protect the market-steering function, as the trademark's holder gets a larger variety of marketing instruments than international exhaustion would allow.³⁷

4 Trademark Exhaustion in EC-Law

The ECJ has since the early 1970:s developed a rich case law on the exhaustion of trademark rights. This case law is based on articles 28, 30 and 295 [30, 36 and 222]. It was in 1989 codified in article 7 of the trademark directive.

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

³² Hans Henrik Lidgaard, "Regional konsumtion i EU hindrar parallelimport från lågprisländer", p. 31-32.

³³ Sirena S.r.l. v. Eda S.r.l. and others, Case 40/70, Datum, [1971] ECR 69 para 7. (hereafter Sirena)

³⁴ SA CNL-SUCAL NV v. HAG GF AG, Case C-10/89, 17.10.89, [1990] ECR I-3711 (hereafter Hag II), para. 13.

³⁵ See for example Hoffman-La Roche Co. AG v. Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH, Case 102/77, 23.5.78, [1978] ECR 1139 (hereafter Hoffman-La Roche); Centrafarm BV v. American Home Products Corporation, Case 3/78, 10.10.78, [1978] ECR 1823; Pfizer Inc. v. Eurim-Pharm GmbH, Case 1/81, 3.12.81, [1981] ECR 2913. (hereafter Pfizer) See also Hag II; IHT Internationale Heiztechnik GmbH och Uwe Danzinger v. Ideal-Standard GmbH och Wabco Standard GmbH, C-9/93, 22.6.94, [1994] ECR I-2798 (hereafter Ideal-Standard); Societe Terrapin (Overseas) Ltd. v. Societe Terranova Industrie CA Kapferer & Co., Case 119/75, 22.6.76, [1976] ECR 1039 (hereafter Terrapin)

³⁶ René Joliet, "Markenrecht und freier Warenverkehr: Abkehr von Hag I" GRUR Int. 1991 p. 180; Lars Pehrson "Common origin-principens uppgång och fall" NIR 1995 p. 22.

³⁷ Hans Henrik Lidgaard, "Regional konsumtion i EU hindrar parallelimport från lågprisländer", p. 54.

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

Even after the introduction of this directive, the Court has based some of its judgments on community exhaustion on articles 28 [30] and 30 [36] of the treaty instead of on the directive. Joliet explains this in an analysis of the Hag II case by referring to the purpose of directives – to harmonize differences between the laws of the member states. He finds that in most cases in which national trademark rules conflict with the demand of the free movement of goods, the conflict between the set of rules is a consequence of the territoriality of trademark rights, not of differences between national laws. The directive does nothing to restrict this territoriality of rights, and is therefore not the proper legal source to solve this type of problems.³⁸ Accordingly, the older case law is of interest also after the introduction of the directive.³⁹

Even if most of the relevant cases have regarded trademarks, the exhaustion principle has developed in a broader context, including the other kinds of intellectual and industrial property. This is in full accordance with article 30 [36], which refers to “industrial and commercial property”.⁴⁰ Additionally, the ECJ has in some cases made references to the wider conception rather than to trademarks only.⁴¹ Hence, some cases regarding other kinds of intellectual and commercial property than trademarks will be examined in this thesis.

4.1 From Article 81 [85] to Articles 28 [30] and 30 [36]

4.1.1 Article 81 [85]

The ECJ has tried different approaches to deal with the market partitioning effects of trademarks. In some initial cases, the Court applied article 81 [85] – the rule on competition control.⁴² The Sirena case is a good example: an American company let

³⁸ Advocate General Jacobs’ opinion to Hag II, delivered at 13.3.90, [1990] ECR I-3725, para. 55. See also René Joliet, “*Markenrecht und freier Warenverkehr: Abkehr von Hag I*” GRUR Int. 1991 p. 183.

³⁹ As the court said in Bristol-Myers Squibb v. Paranova A/S, Case C-427/93 and C.H. Boehringer Sohn, Boehringer Ingelheim KG and Boehringer Ingelheim A/S v. Paranova A/S, Case C-429/93 and Bayer Aktiengesellschaft and Bayer Denmark A/S v. Paranova A/S Case C-436/93, 11.7.96, [1996] ECR I-3457, para. 40, both article 7 of the directive and article 36 of the treaty are intended to reconcile the interests of trademark protection and the free movement of goods. As the two rules pursue the same result, they should be interpreted in the same way. See also Advocate General Jacobs opinion to the case, in which the thought is further elaborated. [1996] ECR I-3457, para. 54-106. See also Advocate General Jacobs’ opinion to Hag II, delivered at 13.3.90, [1990] ECR I-3725, para 55.

⁴⁰ Carl Michael Quitzow, “*Läkemedel och EEC-fördragets regler om fri rörlighet för varor*”, NIR 1991 p. 235; and “*Fria varurörelser i den europeiska gemenskapen. En studie av gränsdragningen mellan gemenskapsangelägenheter och nationella angelägenheter*”, p. 272-273.

⁴¹ An example of this is Deutsche Grammophon GmbH v. Metro-SB-Grossmärkte GmbH & Co. KG., Case 78/70, Datum, [1971] ECR 487. See also section 4.1.2.

⁴² Article 82 [86], which prohibits the abusive use of a dominant market position, is not as useful for this purpose as article 81 [85]. The possibility for a trademark proprietor to prevent third parties from putting into circulation products bearing that trademark in a member state, does not in itself constitute a dominant market position, as article 86 refers to “a substantial part” of the common market. Further, the

its European resellers register the disputed trademark in their respective countries. The Italian reseller used his trademark rights under Italian law to stop the importation of the product from Germany into Italy by a third party. (Such blocking out of competition can be in the mutual interests of the resellers.) When the ECJ tried the case, it found that the trademark rights structure between the companies was utilized in a way forbidden by article 81.1 [85.1], as the companies acted in a concerted practice that prevented trade between the member states. According to article 81.2 [85.2], the companies were forbidden to use their trademark rights in such a way, despite the fact that those rights were not only based on the agreement between them, but also on national legislation.⁴³ However, article 81 can not be used to address all kinds of trade impediments between member states, only those that are the consequence of cartels between companies.⁴⁴

4.1.2 Articles 28 [30] and 30 [36]

The general rule regarding impediments of the free movement of goods between the member states is article 28 [30], which covers all kinds of trade restrictions. It reads as follows:

“Quantitative restrictions on imports and all measures having equivalent effect shall, without prejudice to the following provisions, be prohibited between Member States.”

Article 30 [36] limits the scope of article 28 [30]:

“The provisions of Articles 28 and 29 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality, public policy or public security; the protection of health and life of humans, animals or plants; the protection of national treasures possessing artistic, historic or archaeological value; or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.”

In contrary to these articles, article 81 [85] only covers trade restrictions that are the results of unlawful cartels. However, it took until 1971 before the ECJ used article 28 [30] and 30 [36] in a case regarding the use of intellectual and industrial property as a hindrance to the free movement of goods. The case – Deutsche Grammophon – regarded the copyright to music recordings.⁴⁵ The German record company, after which this case is named, distributed music to, among other places, the German and French markets. When recordings were reimported from France to Germany, Deutsche Grammophon used its copyright under German law to impede the importation. The ECJ was asked by the national Court to apply article 81 [85], but as it found that provision unfitting, it *ex officio* turned to article 30 [36], which must be

relevant market in most cases constitutes of more than product, as the product in question in most cases can be substituted. Sirena, para. 16.

⁴³ Sirena (See footnote 27)

⁴⁴ Bleckmann “*Europarecht*” p. 692-693; Opperman “*Europarecht*” p. 366-367.

⁴⁵ Deutsche Grammophon GmbH v. Metro-SB-Grossmärkte GmbH & Co. KG., Case 78/70. [1971] ECR 487

(hereafter Deutsche Grammophon)

regarded as rather innovative at that time.⁴⁶ The Court pointed out that the article permits trade restrictions on the grounds of protection of intellectual and industrial property, but only when the restrictions do not constitute “*a means of arbitrary discrimination or a disguised restriction between member states*”. The Court proceeded, stating that only restrictions that are protecting the subject-matter of the industrial or the intellectual property can be permitted. The Court found that the recordings in question were marketed by the producer or with his consent, and that the only ground under German law to hinder their import back to Germany was that they were marketed in another member state. To accept this trade restriction would, according to the Court, be contrary to one of the main goals of the treaty, namely to unite the national markets into a single market. Hence, the import restriction could not be accepted. Through this case, the principle of exhaustion was introduced in community law, and the member states were prescribed to regard goods put on the common market as exhausted.⁴⁷

In the following, the details of the principle of community exhaustion will be elaborated.

4.2 Existence and Exercise of Trademark Rights

There is a tension between the principle of exhaustion in community law and article 295 [222] of the treaty. Article 295 prevents EC-law from interfering with national rules on, among other things, industrial and intellectual property:

“This Treaty shall in no way prejudice the rules in Member States governing the system of property ownership.”

According to this provision, the rules on how industrial and intellectual property rights come into existence, how they cease to exist and what their scope is, is left to national courts and legislation. The ECJ has upheld this limitation of the scope of the community law in its case law by making a distinction between the existence and the exercise of such rights. This distinction was overtaken from the case law on competition control. The Sirena case can be brought as an example. The cartel in Sirena was constructed of duly registered trademarks, whose registrations were beyond the reach of the ECJ. However, the consequence of a breach of article 81 [85] is that the agreement constituting the cartel will be rendered void in those parts incompatible with the article, and in such a case the Court had to distinguish between the existence and the exercise of the trademark rights. As their existence could not be changed, the Court restricted their exercise.⁴⁸ The Deutsche Grammophon case also

⁴⁶ Carl Michael Quitzow, “*Fria varurörelser i den Europeiska gemenskapen. En studie av gränsdragningar mellan gemenskapsangelägenheter och nationella angelägenheter.*” p. 273-274.

⁴⁷ The case further shows how the court applies a teleological interpretation of the rules on free movement of goods. Quitzow regards this as one of the more important cases, as the introduction of the exhaustion principle constituted a large restriction on how national rules on intellectual and industrial property can be applied; the case also had considerable consequences on the economic life in the community. Quitzow, *ibid.* p. 274-275.

⁴⁸ Sirena, para. 5.

included this distinction,⁴⁹ and in the following years, it was used by the ECJ in cases on exhaustion.

However, the distinction was left out in the important Hag II case in 1989,⁵⁰ and was not used thereafter. Joliet, one of the judges at the ECJ at that time, has discussed the reason for this. He argues that the distinction between existence and exercise actually is not possible, as restrictions in the exercise of a right in fact are restrictions in the right itself. Hence, when national rules on intellectual and industrial property are formulated in a way that conflicts with article 28 [30] and 30 [36], the scope of that national right must be restricted.⁵¹

4.3 The Specific Subject-Matter

The concept of specific subject-matter was introduced in *Deutsche Grammophon*. The specific subject-matter is to be understood as the core of the intellectual property or industrial property in question, as the exception in article 30 [36] from the principle of free movement of goods only is used to the extent that is necessary to protect the specific subject-matter.⁵² In the words of the Court, article 30 only admits derogation from the principle of free movement of goods insofar as they “*are justified for the purpose of safeguarding rights which constitutes the specific subject-matter of such property*”.⁵³ The Court did, however, not define the subject-matter of copyright in *Deutsche Grammophon*. As the different kinds of industrial and commercial property has their own functions, their specific subject-matters are defined separately.⁵⁴ The definition of the specific subject-matter of trademark rights was given in *Centrafarm/Winthrop*,⁵⁵ and reads as follows:

*”In relation to trade marks, the specific subject matter of the industrial property is the guarantee that the owner of the trade mark has the exclusive right to use that trade mark, for the purpose of putting products protected by the trade mark into circulation for the first time, and is therefore intended to protect him against competitors wishing to take advantage of the status and reputation of the trade mark by selling products illegally bearing that trade mark.”*⁵⁶

⁴⁹ *Deutsche Grammophon*, para. 11.

⁵⁰ *SA CNL-SUCAL NV v. HAG GF AG*, Case C-10/89, 17.10.89, [1990] ECR I-3711 (hereafter Hag II)

⁵¹ René Joliet, “*Markenrecht und freier Warenverkehr: Abkehr von Hag I*”, GRUR Int. 1991 p. 177-184.

⁵² Tilman E. Lüder “*Die Rolle des nationalen Markenrechts in einem europäischen Binnenmarkt*”, EuZW 1994 p. 113.

⁵³ *Deutsche Grammophon*, para. 11.

⁵⁴ The specific subject-matter of patent rights was defined in the joined cases *Merck & Co. Inc., Merck Sharp & Dohme Ltd. and Merck Sharp & Dohme International Services BV v. Primecrown Ltd, Ketan Himatlal mehta, Bharat Himatlal mehta and Necessity Supplies Ltd, C-267/95*, and *Beecham Group plc v. Europharm of Worthing Ltd.*, Case C-268/95, 5.12.96, [1996] ECR I-6285 as “*in particular, in order to reward the creative effort of the inventor, to guarantee that the patentee 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 licenses to third parties, as well as the right to oppose infringements.*”

⁵⁵ *Centrafarm BV and Adriaan de Peijper v. Winthrop BV*, 16/74, 31.10.74, [1974] ECR 1183 (hereafter *Centrafarm/Winthrop*)

⁵⁶ *Centrafarm/Winthrop* para. 8.

From this definition follows that goods that are imported from other member states, if marketed through the proprietor of the trademark or with his consent, can not offend the specific subject-matter of that trademark right. The prohibition by a member state of the importation of such goods is abusive to the principle of free movement of goods.⁵⁷

4.4 The Principle of Common Origin Found and Abandoned

4.4.1 The Problem

Trademarks are – with an exception of the common EC-trademark – given on national basis, which divides the common market into 13 “trademark territories”.⁵⁸ When the holder of a trademark wants to protect it throughout the whole community, he will have to register it in all member states, all in all 13 registrations. He then has the exclusive right to market his product in every country of the Union.

However, when the ownership of a trademark is split-up on more than one hand, the territoriality of trademark rights will come into a conflict with the principle of free movement of goods on the common market. The circulation of goods from one of the proprietors will infringe the trademark rights of other proprietors, if the goods find its way into the latter's countries. This conflict of principles needs to be resolved, either by letting the goods, under certain circumstances, circulate freely on the common market, or by upholding the rights of the different trademark owners to stop importation into their respective countries.⁵⁹ As we will see, it is today the view of the ECJ that the rights of the trademark owners should be upheld, as a necessary effect of the territoriality of the rights.

A similar situation can be the case when two trademarks that have arisen independently of each other, but easily can be confused, are marketed in the same member state.⁶⁰ Today, the Court judges such a situation in the same way as if the trademarks had a common origin, but during the 1970:s and 1980:s, the Court distinguished between these kinds of situations.

⁵⁷ Tilman E. Lüder “*Die Rolle des nationalen Markenrechts in einem europäischen Binnenmarkt*”, EuZW 1994 p. 113.

⁵⁸ The common Benelux trademark is from this viewpoint just another trademark territory within the common market.

⁵⁹ Quitzow, “*Fria varurörelser i den Europeiska gemenskapen. En studie av gränsdragningar mellan gemenskapsangelägenheter och nationella angelägenheter.*” p. 282.

⁶⁰ Before the trademark directive, the ECJ did not see as its task to decide if there was a risk of confusion between two trademarks, but left such considerations to the national courts, however subjected to the second sentence of article 36. [*Deutsche Renault v. Audi*, Case C-317/91, 30.11.93, [1993] ECR I-6227, para. 29-38] After the trademark directive, the area is now harmonized. See for example Advocate General Jacobs’ opinion to *SABEL BV v. Puma AG, Rudolf Dassler Sport*, Case C-251/95, delivered at 29.4.97, [1997] ECR 6193. See also Quitzow *ibid* p. 283.

4.4.2 The Principle of Common Origin – Hag I

The problem of split up trademarks indicated above was put before the ECJ in 1974 in the first of two cases regarding the trademark “KAFFEE HAG”.⁶¹ Hag AG originally registered KAFFEE HAG in Germany in the beginning of this century. Later, as the company expanded into Belgium and Luxembourg, it was also registered in those countries, and held by subsidiaries of Hag AG. During the Second World War, the subsidiaries in those countries were seized as enemy property by the authorities, and after the peace, the Luxembourgian trademark eventually became the property of the company van Zeulen Frères. Hag AG continued to produce coffee, and as it began to export its products to Luxembourg, Van Zeulen Frères turned to a national court to oppose the importation as an infringement of its trademark. Hag AG meant on the other hand that a prohibition on the exportation of its coffee under the disputed trademark would be contrary to article 28 [30]. The case was brought before the ECJ for a preliminary ruling.

In the judgement, it shows that the Court at that time regarded trademark rights as scarcely more than trade barriers. The free movement of goods was prioritized before trademark protection, and the Court let the German company export its coffee into Luxembourg. The consequence of this ruling, however, was that the consumers would be at risk to confuse these brands, and also other, if similar situations regarding other trademarks would arise. The Court recognized this problem, but stated that the consumers could be informed on the origin of products through other means, not affecting the free movement of goods. The argumentation in this judgment is rather short, and the Court did not explain why two independent trademarks sharing a common origin should be treated differently than trademarks with separate origins.⁶²

The principle of common origin was confirmed in the Terrapin judgment, in which the German company Terranova held three trademarks containing the word “Terra”. A British company with a similar, (not identical) trademark wanted to market its products in Germany. The German trademark proprietor Terrapin wanted to stop the marketing, which was successful, as, which was clearly mentioned by the Court, the trademarks did not share a common origin. The judgment thus contained a confirmation of the principle of common origin. The principle was now well established, and became regarded as applicable on all intellectual and industrial property.⁶³

⁶¹ Van Zuylen Frères v. Hag AG, Case 192/73, 3.7.74, [1974] ECR 731.

⁶² The practical consequences of this judgment seem to have been problematic: suppose that a company A has the trademark X registered in all member states. Later, the company B acquires the right to the trademark in one of those countries from A. Despite that B now is the owner of the trademark X in an EU-country, it will not be able to stop the importation of products that A has marketed under the trademark X in another member state. As long as the common-origin principle was applied, B could never acquire the same right to the trademark that he would have had, if he had originally registered it himself. See Lars Pehrson, “*Common origin-principens uppgång och fall*”, NIR 1995, p. 13.

⁶³ Lars Pehrson, “*Common origin-principens uppgång och fall*”, NIR 1995, p. 14

4.4.3 A Change of Views – Hag II⁶⁴

The principle was, however, abandoned by the Court in 1990 in another case regarding the trademark Café Hag. Van Zeulen Frères now had changed names into SA CNL-SUCAL NV (SUCAL), and was exporting its coffee into Germany under the trademark in question. The German Hag AG company opposed the importation, and as the dispute reached the Bundesgerichtshof, that court asked the ECJ for a preliminary ruling. This time, the facts were slightly different as the coffee was imported into the country where the common origin of the trademark was situated. Would the principle of common origin still be applicable? As already suggested, the answer was no.

The Court begun its argumentation with the statement that the first Hag case had to be reconsidered in the light of the principle of subject-matter elaborated in its case law.⁶⁵ The Court then, in contrast to Hag I, emphasized the importance of trademarks in a market economy: “...an undertaking must be in a position to keep its customers by virtue of the quality of its products and services, something which is possible only if there are distinctive marks which enable customers to identify those products and services.”⁶⁶

Further, the trademark’s function to guarantee the quality of a product was stressed. The third main point of the case was that the proprietor of a mark must be guaranteed the exclusive right to put goods bearing his trademark into circulation on the market. Accordingly, the lack of any consent from the side of Hag AG to the putting into circulation of SUCAL's products was decisive.

The Court's conclusion follows logically, given these three premises: “...in a situation such as the present case, ... each of the trade mark proprietors must be able to oppose the importation and marketing, in the Member State in which the trade mark belongs to him, of goods originating from the other proprietor, in so far as they are similar products bearing an identical mark or one which is liable to lead to confusion”.⁶⁷

This ruling did not change the interpretation of article 28 [30], the ban on trade restrictions, but the scope of the exception in article 30 [36] was widened. Hence, the member states were given more room for the protection of intellectual and industrial rights in their respectively countries. A new balance between the principle of free movement of goods, and the territoriality of trademarks was established, as a consequence of the Court’s higher valuation of trademark rights. However, Hag II left some questions unanswered. Both Hag I and II, and Pharmon/Hoechst had regarded involuntarily splitting of the rights to intellectual and commercial property. Would the principle of common origin still be applicable if the trademark rights were *voluntarily* split up on more than one proprietor?

⁶⁴ The analysis of Hag II is based on René Joliet “*Markenrecht und freier Warenverkehr: Abkehr von Hag I*”, p. 179-181.

⁶⁵ Para. 10-12 The court especially mentioned Deutsche Grammophon, Centrpharm/Winthrop, and Pharmon BV v. Hoechst AG, Case 19/84, 9.7.85, [1985] ECR 2281 (hereafter Pharmon/Hoechst).

⁶⁶ Hag II, para. 13.

⁶⁷ Hag II, para. 19.

4.4.4 Ideal-Standard Confirms the New Approach

That question was answered in *Ideal-Standard* (1994), after which it was clear that the principle of common origin no longer was valid.⁶⁸ The judgment was given after a session in plenum, and with a very thorough argumentation, which suggests that the Court wanted to put a lot of weight to it.

The case regarded the trademark “Ideal-Standard” which originally was held in German and France by the American Standard Group through subsidiaries in the respective countries. In 1984, the right to the French trademark was sold on grounds of financial difficulties, and eventually it came in the possession of CICH, a French company. When CICH marketed its products in Germany under the trademark “Ideal-Standard”, the German *Ideal-Standard GmbH* brought proceedings against CICH. The case reached the *Oberlandesgericht Duesseldorf*, which asked the ECJ for a preliminary ruling.

The factual differences between *Ideal-Standard* and *Hag II* are essentially that the trademark rights this time were split-up voluntarily. The ECJ had to answer the following question: can a company “A”, which is the holder of a trademark in a member state, stop the importation of products bearing the same trademark produced by another undertaking “B” in another member state, when B has acquired the right to the mark in the state in which he produces his goods from A?⁶⁹

In the ruling, the Court stressed the territoriality and independence of the national trademarks in the community. Then the Court confirmed the principle of exhaustion of trademark rights, based on the concept of the specific subject-matter. This time, the Court laid its emphasis on the rightholders opportunity to control the quality of the product bearing his brand, while it in *Hag II* stressed the origin of the product. The actual difference between the two judgments on this point does not, however, seem to be large.⁷⁰ When the economical or contractual link between two companies is strong enough, the control over the quality of the product can be effectively exercised also between two otherwise independent companies owning the rights to a trademark in respective countries.⁷¹ In *Ideal-Standard*, however, there lacked such a link between the two companies, and accordingly, the Court came to the conclusion that *Ideal-Standard GmbH* should have the right to use German trademark law to stop the importation of CICH’s products.

The Court had now chosen to let trademark proprietors oppose the importation of branded goods bearing a voluntarily split-up trademark, even if both the brand of the importer and of the objecting party once had a common origin. This means that trademarks with a common origin no longer was dealt with differently than other trademarks.

⁶⁸ The principle of common origin was after this case commonly regarded as abandoned also regarding other intellectual and industrial property rights. See Lars Pehrsson “*Common origin-principens uppgång och fall*”, NIR 1995, p. 22.

⁶⁹ Lars Pehrsson, *ibid*, p. 18.

⁷⁰ Lars Pehrsson, *ibid*, p.19-20.

⁷¹ For a further discussion on consent of the proprietor of a trademark, and on economical links, see section 4.5.

4.5 Consent of the Proprietor and the Point of Control

As we have seen, the trademark rights to a product are exhausted when the product is put into circulation on the market by the proprietor of that mark or with his consent. If the consent is lacking, the marketing of the product in question can be stopped by the proprietor of the trademark. The concept of consent has been developed by the ECJ in a number of cases, in which the right to use a certain trademark – or other industrial and commercial property – has been split up on more than one person, either by an act of public authorities, or voluntarily by the holder of the trademark.

In *Pharmon/Hoechst* in 1985, the Court arrived at the conclusion that goods produced under a compulsory patent license would not exhaust the rights of the owner of the patent. The ECJ based its ruling on, among other things, that the owner of the patent right never had given his consent to the marketing, as the license was compulsory. In the joined *Merck* cases from 1996, the Court stated that if a patent holder is legally obliged to market his product, it can not be presupposed that he has given his consent to the marketing.^{72 73}

When it comes to trademark rights, compulsory licenses or legal obligations to market a product in a certain member state seems to be less likely. Nevertheless, the question of consent has been at stake also in this area, in cases with split-up trademarks. In *Hag II*, the determinant factor was the lack of consent from the side of *Hag AG*, and in *Ideal-Standard*, the importation of goods marked with "Ideal-Standard" could be stopped by the German trademark holder, as he had not consented to the marketing of the products in France, (by the French trademark holder). The French company argued that the mere sale of the trademark right included a consent from the side of the American Standard Group to give the French assignee the right to use the trademark on its products. The Court rejected that view: "*The consent implicit in any assignment is not the consent required for application of the doctrine of exhaustion of rights.*"⁷⁴ And the Court continued: "*For that, the owner of the right in the importing State must, directly or indirectly, be able to determine the products to which the trade mark may be affixed in the exporting state and to control their quality.*"⁷⁵ That was not the case in *Ideal-Standard*.

However, when a trademark is assigned from one person to another, in many cases the companies are linked to each other in one way or another. The companies are perhaps parent company and subsidiary, or two subsidiaries belonging to the same group. There could also be the case of a license agreement, or the company to which the trademark is assigned could be the exclusive distributor of the assignor. The ECJ discussed such scenarios in *Ideal-Standard*, and found that in the cases in which there is an economical link between two companies using the same trademark, the consent of the company in the importing state to the marketing of the trademarked product

⁷² *Merck & Co. Inc., Merck Sharp & Dohme Ltd. and Merck Sharp & Dohme International Services BV v. Primecrown Ltd, Ketan Himatlal mehta, Bharat Himatlal mehta and Necessity Supplies Ltd, C-267/95, and Beecham Group plc v. Europharm of Worthing Ltd., C-268/95, 5.12.96, [1996] ECR I-6285.*

⁷³ *Quitow "Fria varurörelser i den Europeiska gemenskapen. En studie av gränsdragningar mellan gemenskapsangelägenheter och nationella angelägenheter."* p. 277-279.

⁷⁴ *Ideal-Standard*, para. 43.

⁷⁵ *Ideal-Standard*, para. 43.

could be supposed. The decisive factor in such cases is the possibility of control by one person. As the Court stated discussing license agreements: “*The origin which the trade mark is intended to guarantee is the same: it is not defined by reference to the manufacturer but by reference to the point of control of manufacture.*”⁷⁶ And the Court continued, making an important point: “*The determinant factor is the possibility of control over the quality of goods, not the actual exercise of that control.*”⁷⁷ Two situations were discussed in more detail, firstly that of a license agreement. In a license agreement, the licensor can control the quality of the product through clauses in the contract. Hence, if the licensor accepts the manufacture of poor quality goods, he must bear the responsibility. Secondly, a situation in which the manufacture of a product is decentralized within a group of companies and the subsidiaries in each of the member states are producing products whose quality is geared to the particulars of each national market. In such situations the group must accept the parallel importation of each other’s products, as the control over the quality lies on the group in its entirety.^{78 79}

4.6 Repackaging and Relabelling of Parallel Imported Products

In a few cases, the ECJ has dealt with the problem of relabelling and repackaging of parallel imported products. Some products are not easily moved from one market to another, because of the design or size of the package, the language of the enclosed information, or some other circumstance that has to do with the packaging or labeling of the product. Such circumstances can obviously be a hindrance for the free movement of goods, and has been used by trademark holders to prevent parallel importation of their goods, especially in the pharmaceutical branch. Parallel importers have had to change the packaging, add information to it, or in some other way change the label or package to be able to market the product in an other member state.⁸⁰

A trademark holder is in principle allowed, according to article 30 [36], to use his national laws to stop the parallel importation of changed products, but under certain circumstances, the Court has also allowed parallel importation of changed or impaired products. The principle of free movement has in those cases been given more weight than an absolute protection of the integrity of the trademark. Five conditions have to be satisfied. *First*, it must be shown that the impediment of importation would contribute to an artificial partitioning of the common market, *Secondly*, it must be shown that the repackaging cannot affect the original condition of the product. *Thirdly*, the new packaging must clearly state who repackaged the product and the name of the manufacturer. *Fourthly*, the presentation of the product must not damage the reputation of the trademark or of its owner. *Fifthly*, the holder of the trademark

⁷⁶ Ideal-Standard, para. 37.

⁷⁷ Ideal-Standard, para. 38.

⁷⁸ Ideal-Standard, para. 37-38. See also section 4.7. in this thesis.

⁷⁹ Lars Pehrson “*Common origin-principens uppgång och fall*” p. 20-21.

⁸⁰ See for example Hoffman La-Roche, Pfizer, Bristol-Myers Squibb v. Paranova A/S, Case C-427/93 and C.H. Boehringer Sohn, Boehringer Ingelheim KG and Boehringer Ingelheim A/S v. Paranova A/S, Case C-429/93 and Bayer Aktiengesellschaft and Bayer Denmark A/S v. Paranova A/S Case C-436/93, 11.7.96, [1996] ECR I-3457 (hereafter Bristol-Myers Squibb); MPA Pharma v. Rhône-Poulenc Pharma, Case C-232/94, 11.7.96, [1996] ECR I-3671; Frits Loendersloot v. George Ballantine & Son Ltd and others, Case C-349/95, 11.11.97, [1997] ECR I-6244 (hereafter Ballantine). See also Quitzow, “*Läkemedel och EEC-fördragets regler om fri rörlighet för varor*”, p. 232-237.

must be informed of the measures, and, at least when it comes to pharmaceutical products, he must be presented a sample of the repackaged product.⁸¹

4.7 Differences in Quality of the Marketed Goods – Dansk Supermarked

In the Dansk Supermarked case, the company Imerco had anniversary china sets produced, marked with its trademark.⁸² The sale of the sets was restricted to a certain area in the common market, including Scandinavia. However, it was agreed with the British manufacturer, that substandard pieces might be sold in the UK, but not in any case exported to Scandinavia. Dansk Supermarked, the proprietor of several supermarkets, was still able to obtain a number of sets, which it offered for sale in Denmark at prices lower than Imerco's, without notifying the customers about the poorer quality of the pieces. Imerco protested before the Danish courts against the marketing of the substandard pieces, and as the case reached the Højesteret, that court asked the ECJ for a preliminary ruling. The ECJ found, with a reference to Terrapin, that Imerco simply did not have the right to oppose the marketing by Dansk Supermarked on grounds of protection of its trademark right or copyright, as the sets were marketed in the UK with the consent of Imerco.⁸³

The Court would later discuss the situation that was the case in Dansk Supermarked from a more conceptual point of view, namely in an *obiter dictum* to Ideal-Standard. In short, it said that if a company or a group of companies gears the quality of its products to the particulars of the national markets, it should not have the possibility to use differences of quality as a reason to separate the national markets from each other.⁸⁴

Dansk Supermarked shows that the ECJ gives trademark exhaustion a strict interpretation. Although that Imerco's opposition to the importation might have appeared legitimate for a number of reasons, the Court chose to turn it down.⁸⁵

4.8 Regional or International Exhaustion

Some countries apply international exhaustion of trademark rights, which means that the exclusive right to a trademark will be exhausted, irrespective of where the goods first were marketed (by the owner or with his consent). Other countries have chosen to let the rights of their trademark holders' be exhausted only if the goods were first marketed on the domestic market. A third group of countries, like the member states of the EU, applies regional exhaustion, which means that the marketing of goods in any of the member states will exhaust the trademark in question. When choosing one of these approaches, a country will have to balance a number of interests. One the one

⁸¹ Rolf Sack "Zeichenrechtliche Grenzen des Umpackens fremder Waren" GRUR 1997 p. 10-11.

⁸² Dansk Supermarked A/S v. A/S Imerco, Case 58/80, 22.1.81, [1981] ECR 181 (hereafter Danish Supermarked).

⁸³ Quitzow, "Fria varurörelser i den Europeiska gemenskapen. En studie av gränsdragningar mellan gemenskapsangelägenheter och nationella angelägenheter." p. 287-288.

⁸⁴ Ideal-Standard, para. 37-38. See also 4.5 in this thesis.

⁸⁵ Quitzow, "Fria varurörelser i den Europeiska gemenskapen. En studie av gränsdragningar mellan gemenskapsangelägenheter och nationella angelägenheter." p. 287-288.

hand are the interests of those companies that market their products on an international level – in a country with international exhaustion, their revenues would be endangered through parallel importation from low price markets. On the other hand are the interests of the consumers – parallel importation promotes price competition and pushes prices down. Then again, the problematics can probably not be reduced to this simple conflict of interests, as international exhaustion might have long term effects on future investments.⁸⁶ One should also take into account the lack of reciprocity if the EU would unilaterally introduce international exhaustion. However, considerations of such questions of international commercial policy are in any event beyond the task of the ECJ.⁸⁷

4.8.1 Cases on Third Country Goods Prior to the Trademark Directive

The importation of third country goods bearing trademarks protected in the EU was at stake before the ECJ a few times before the adoption of the trademark directive. In three cases from 1976 regarding the importation of music recordings from a non-member state, the Court found that articles 28 [30] and 30 [36] do not regulate obstacles to the free trade between member states and third countries.⁸⁸ Consequently, the case law on trademark exhaustion was not applicable, and it was possible for the member states in question to prohibit the importation. A conclusion from these cases is that the community law did not prescribe international exhaustion, but it did not, at least not explicitly, prohibit it either.⁸⁹ Then, in 1989, the trademark directive harmonized the exhaustion of trademarks. The directive does not, however, explicitly regulate if a member state is allowed to apply international exhaustion, or if regional exhaustion is compulsory.⁹⁰

4.8.2 Silhouette

That question remained unanswered until the Silhouette judgment in 1998.⁹¹ The dispute regarded a lot of spectacles, manufactured by the Austrian company Silhouette International Schmied GmbH & Co. KG (Silhouette). Silhouette owns the trade mark “Silhouette”, that is registered in most countries in the world, including Austria. It produces spectacles in the higher price ranges, which in Austria are distributed by Silhouette directly to specialist opticians. In 1995, Silhouette dumped a stock of outdated spectacles to a purchaser in Bulgaria, with an instruction not to sell the glasses outside Bulgaria or the former Soviet Union. However, the Austrian low price market Hartlauer managed to acquire the goods and offered them for sale in Austria the same year. Silhouette considered the sale by Hartlauer to be harmful to the image of its

⁸⁶ Hans Henrik Lidgaard, “*Regional konsumtion i EU hindrar parallellimport från lågprisländer*”, p. 54, 57-58.

⁸⁷ Advocate General Jacobs’ opinion to Silhouette, para 51 (not yet published).

⁸⁸ EMI Records Ltd v. CBS United Kingdom Ltd, Case 51/75, 15.6.76, [1976] ECR 811; EMI Records Limited v. CBS Grammofon A/S, Case 86/75, 15.6.76, [1976] ECR 871; EMI Records Limited v. CBS Schallplatten GmbH, Case 96/75, 15.6.76, [1976] ECR 913

⁸⁹ In 1982 this approach was confirmed in the field of copyright in Polydor Ltd and RSO Records Inc. V. Harlequin Records Shops Ltd and Simons Records Ltd, Case 270/80, 9.2.82, [1982] ECR 329.

⁹⁰ Hans Henrik Lidgaard, “*Regional konsumtion i EU hindrar parallellimport från lågprisländer*”, p. 34-36.

⁹¹ Silhouette International Schmied GmbH & Co. KG v. Hartlauer Handelsgesellschaft mbH, Case C-355/96, 16.7.98 (not yet published)

trademark, and tried to prohibit the resale using national remedies. It failed in the first and second instance, as Austria at that time was applying international exhaustion of trademark rights. The Oberster Gerichtshof, however, turned to the ECJ to ask if international exhaustion was allowed under article 7(1) of the trademark directive.

Firstly, the ECJ noted that the directive does not prescribe international exhaustion. If so, as the Advocate General pointed out, the directive would not have referred only to marketing in the community.⁹² The view of Hartlauer was that article 7 would nevertheless allow a member state to provide for international exhaustion. The reason being that the article would be limited to require the member states to provide for trademark exhaustion within the community. According to this view, the directive does not comprehensively resolve the question of exhaustion, but leaves it open for a member state to adopt rules going further than those explicitly laid down.⁹³ However, the Court found this interpretation contrary to the directive. Not only the wording of article 7, but also the purpose and the scheme of the directive points out that it fully harmonizes the question of exhaustion, not leaving it open for member states to provide for international exhaustion. Moreover, the Court continued, only that interpretation is fully capable to safeguard the functioning of the internal market. A situation in which some member states could provide for international exhaustion, while others provided for community exhaustion, would give rise to trade barriers between the member states. That argument was in the proceedings further elaborated by the Commission and some of the member states: If a member states were free to determine whether trademark owners could prevent importation from third countries, the same products could be the subject of parallel imports into one member state but not into another. It would be no solution to this to let goods once imported into a member state providing for international exhaustion to benefit from the free movement on the internal market. That would have the effect of imposing international exhaustion on all member states.⁹⁴ Finally, the Court pointed out that the Community authorities always could extend the exhaustion to products put on the market in non-member countries by entering into international agreements, as already had been done through the EEA Agreement.⁹⁵

The judgement might at a first glance seem contrary to some aspects of the Court's case law. The Court has a number of times emphasized that the function of trademarks is to point out the origin of the product to the consumer.⁹⁶ As Sweden argued during the proceedings, it is no part of that function to enable the trademark owner to divide the market. This argument was answered by the General Advocate, which on the one hand agreed on the Swedish point, but on the other hand, he added that the case law in which the function of origin has been discussed, was developed in the context of the community market, not the world market, and that articles [28] 30 and [30] 36 do not regulate the relationship between the community and third countries.⁹⁷

⁹² Advocate General Jacobs' opinion to *Silhouette*, para. 31 (not yet published).

⁹³ This was also the view of the Swedish government, that intervened in the case.

⁹⁴ Advocate General Jacobs *ibid.*, para. 42.

⁹⁵ *Silhouette* para. 30.

⁹⁶ *Hoffman La-Roche* para. 7; *Ideal-Standard* para. 45-46; and more recent, *Bristol-Meyers Squibb* para. 47 and *Ballantine* para. 24.

⁹⁷ Advocate General Jacobs' opinion to *Silhouette*, para 48-49.

The consequences of *Silhouette* are that regional, community-wide exhaustion now is compulsory to all members of the European Union. While some countries already applied it before the judgment, others, like Sweden, have to adapt.⁹⁸ Parallel importers cannot continue the importation of trademarked products from third countries without risking litigation. Parallel importation from other member states can, however, continue as usual, and there seems to be no reason not to allow the parallel importation of a trademarked product from a third country, if it is sold in the EU under another trademark.⁹⁹

4.8.3 Cases Pending Before the Court

There are at the moment at least five cases pending before the Court regarding international aspects of community trademark exhaustion, so the Court will soon have the opportunity to not only confirm *Silhouette*, but also to clarify the relationship between the EU and the EEA regarding exhaustion.¹⁰⁰ ¹⁰¹ In one of these cases, “*Sebago*”, the Advocate General has already given his opinion, in which he essentially states that the Court this time only will have to confirm its case law, including *Silhouette*.¹⁰²

5 Internet Trade and Exhaustion

Internet commerce has boomed during the last few years. Estimations differ, but most experts expect a continuation of the rapid increase.¹⁰³ Trade on the Internet can be divided into trade in tangible and intangible products. Online trade in intangible, digital products is a new phenomenon, quite different from trade in tangible goods. Therefore, the two kinds of trade will be discussed in separate sections.

5.1 Tangible Goods

5.1.1 The Commerce

Producers and retailers of tangible goods have adopted a few different approaches towards the increasing commerce on the Internet. While many feel that they should establish themselves in this new medium, only few of them venture fully into Internet trade. It is rather considered a supplement to usual retailing, maybe because of the existing nets of distributors and resellers, who are not interested in the move of trade

⁹⁸ The Swedish government has expressed that it will work on the EU level in favour of a change from regional exhaustion to international exhaustion. See Lidgaard “*Regional konsumtion i EU hindrar parallellimport från lågprisländer*” p. 57.

⁹⁹ Lidgaard, *ibid.* p. 54.

¹⁰⁰ C-278/97 (*Wrangler*); C-370/97 (*Polo*); C-4/98 (*Calvin Klein*); C-80/98 (*3Com Corporation*); C-173/98 (*Sebago*). See Proceedings of the Court of Justice and The Court of First Instance of the European Communities nr. 23/97, 30/97, 6/98, 11/89 and 18/89.

¹⁰¹ Lidgaard discusses which different approaches the court might adopt towards international exhaustion, with the conclusion that it probably will stick to the solution from *Silhouette*. Lidgaard, “*Regional konsumtion i EU hindrar parallellimport från lågprisländer*”, p. 50-53.

¹⁰² Proceedings of the Court of Justice and The Court of First Instance of the European Communities nr. 9/99.

¹⁰³ See for example Weje Sandén, “*Nätet som marknadsplats*”, Teldok 123, p. 9-12.

from traditional shops to Internet shops. Many producers depend heavily on their distribution nets.¹⁰⁴ Among those that have invested large sums in consumer oriented Internet trade are a few CD shops, bookshops and computer hardware shops.¹⁰⁵ Books and CD's have been popular items, partly because they are highly standardized goods; there is not much need to physically examine a book or a CD when deciding if you want to buy it. Another convenient thing with Internet trade is that the stores can be easily searched through computerized search engines, so that the customer is able to find the desired product quickly. In addition, Internet stores often have a greater inventory of goods than traditional stores.¹⁰⁶

According to Lars Forsebäck, in his analysis of consumer-oriented Internet commerce in Sweden, intermediaries between the customers and the producers are needed, as the consumer lacks the possibility to effectively find the most attractive buy in the vast supply of offerings.¹⁰⁷ The many search engines are effective but crude tools for finding web-sites with a certain content.¹⁰⁸ So-called "intelligent agents" are more effective in finding the more specialized information. These agents are software customized for specialized searching, in some cases adapted to the special needs and preferences of the user.¹⁰⁹ There are also virtual "market places", where a lot of offers from different companies are collected on one Internet site.¹¹⁰ Another intermediary is the so-called "advertisement-market". On such sites, a user can place an offer or a bid on a certain product. The owner of the site connects the sellers with the buyers, a service rendering him a commission, or which he finances in some other way, for example by selling advertisement space.¹¹¹ The intermediaries function as a link between the consumer and Internet traders through which much of the trade is directed. Forsebäck expects an increase of the cross-border trade. Where price differences are large enough, which often is the case regarding for example groceries, it might, despite transport costs, be cheaper to buy them in a neighboring country. An Internet shop can provide a convenient way to place the order.¹¹²

In order to expand into new markets in other countries it might today be sufficient to establish a web-shop. Hence, a person that wants to market his goods outside his own

¹⁰⁴ Lennart Forsebäck, "Cybershoppare, intermediärer & digitala handelsmän - elektronisk handel i ett hushållsperspektiv", Teldok 120 p. 95. See also Weje Sandén, *ibid.* p. 151.

¹⁰⁵ WWW.amazon.com/ is a popular Internet bookstore, which is based in the United States. A similar Swedish shop is www.bokus.com/. WWW.boxman.com/ is a Swedish Internet shop specialized in CD, DVD, computer games and videotapes. WWW.dell.com/ is a producer of computer hardware that has ventured largely on Internet trade. Groceries delivered to the door might be a new trend, see for example www.matomera.se/ and www.nk.se/. (all accessed 17.5.99)

¹⁰⁶ Regarding books, see Weje Sandén, "Nätet som marknadsplats - De svenska pionjäreerna", Teldok 123, p. 58-66.

¹⁰⁷ Lennart Forsebäck, "Cybershoppare, intermediärer & digitala handelsmän - elektronisk handel i ett hushållsperspektiv", Teldok 120, p. 95-105.

¹⁰⁸ A few of them are www.altavista.com/, www.yahoo.com/ and www.evreka.com/ (all accessed 17.5.99)

¹⁰⁹ Lennart Forsebäck *ibid.* p. 102.

¹¹⁰ Two Swedish examples are www.passagen.se/ and www.torget.se/. An example of a specialized market place is www.bytbil.com/. (all accessed 17.5.99)

¹¹¹ For example www.passagen.se/koposalj/.

¹¹² Lennart Forsebäck, "Cybershoppare, intermediärer & digitala handelsmän - elektronisk handel i ett hushållsperspektiv", Teldok 120, p. 73-75. The German supermarket Warendienst OCC GmbH is known in Sweden for having sold alcoholic beverages in Sweden to German prices during a short period. Today they are selling and delivering cheap groceries. See occ.pegit.se/ (17.5.99)

country will not have to build a distribution net there, or even import the goods into that country prior to the sale. As international trade thus is made easier through the Internet, the adoption of this new technology might lead to an increase in the shipping of goods between countries.

5.1.2 Exhaustion

Regarding the problem of exhaustion of trademark rights, sale of tangible goods over the Internet is in many ways comparable to catalogue shopping. The Internet merely provides a new way for the company to present their catalogue. When orders are placed, the shipping of the goods is executed as before the Internet. However, there are a few special problems depending on some differences between the Internet and other advertising media.

5.1.2.1 Marketing by the Rightholder or With His Consent

The ECJ has clearly defined under what circumstances trademark rights are exhausted on the common market, namely if the goods are put on the market by the proprietor of the trademark or with his consent. This applies both to traders established within the EU and outside of it. As the Internet is a global medium, it is possible to reach a web-site from any computer connected to the net. A trademark owner that is marketing his goods from a web-site in, for example the United States, might very well get orders from overseas, for example from Europe. When he sells his goods on the common market, his trademark rights to them will be exhausted, just like what happens to any trader. However, it could be clarified, only the trademark rights of the particular item or batch of items that are sold will be exhausted. That is, as the General Advocate Jacobs stated in the not yet decided Sebago case, conclusive from the trademark directive and the Court's case law.¹¹³

As English is the main language of the Internet, and many shops seeking an international audience state their prices in dollar, the use of English or dollars does not necessarily imply that the shop is located in the US. Hence, a web-shop in the US aiming at the domestic market might attract buyers from the EU without intending to do so – the European customers might be thinking that the shop chooses English and dollars only to be able to attract buyers from the rest of the world. It is also possible that web-shops located in other countries, for example the former Soviet Union, unintentionally will attract buyers from the EU if it chooses English as its language and dollars as its currency. If the web-shop is automated, and the seller does not supervise every sale, he might find himself shipping goods into the EU unintentionally. However, according to some of the ECJ's findings in *Ideal-Standard*, it is plausible to argue that the seller should be regarded as having consented to the sale, even if he does not have the direct control over every single transaction. This is due to the fact that the seller has the possibility to exercise control by changing the selling routines. In one part of the *Ideal-Standard*'s reasoning, the Court stressed the possibility of control over the manufacture of products.¹¹⁴ It is not farfetched to use

¹¹³ *Sebago Inc. and Ancienne Maison Dubois et Fils SA v. GB-Unic SA*, C-173/98. The opinion by Advocate General Jacobs was delivered on 25.3.99.

¹¹⁴ See section 4.5.

the same argument on the seller's possibility of control over the marketing. Neither would it be burdensome to seller, as he controls instruments with which he easily could take over the marketing. He could, for example, state on the web-pages of the shop that he does not deliver to some countries, or program his shop not to process orders from them. Hence, it appears plausible to argue that if the seller delivers to the common market, the goods should be exhausted there even if the deliverance was unintentional.

Above it was proposed that the Internet could have problematic consequences from the view that it might lead to an increase of trademark infringements. This may especially be the case when the brand marking imported goods is likely to be confused with a brand that is protected in the importing state. The person holding the trademark in the importing state can, according to the Court's case law, oppose to the marketing of imported goods, if the trademarks are likely to be confused with each other.¹¹⁵ However, when the trade moves over to the Internet, the trademark proprietor in the importing member state will have fewer chances to detect the import and act upon it. This is due to the fact that it no longer is necessary to build a net of distributors to market one's goods on new markets. If this hypothesis is true regarding trade within the EU, the rights conferred to the trademark owner through the *Terrapin* and *Ideal-Standard* cases, might be weakened.

5.1.2.2 Marketing by Others

When goods are sold on the market, their trademarks are exhausted and anyone can buy and sell those goods, taking advantage of the reputation of the trademark. However, the EU only accepts exhaustion if the goods were sold on the common market. The Internet is a global medium, something which is likely to challenge the obstacles to trade between the EU and the rest of the world raised by the ECJ through the *Silhouette* judgment.¹¹⁶ This could be illustrated by an example. Suppose that somebody buys a lot of Tommy Hilfiger clothes on the US market, and thereafter markets them on his web-site, aiming at the European market where Tommy Hilfiger clothes are considerably more expensive. When a customer buys clothing from that web-shop, the parallel importer might send them using an ordinary mail sending. As the EU applies regional exhaustion, such parallel importation would infringe the exclusive rights of the holder of the Tommy Hilfiger trademark in the EU. It would be more difficult to stop this importation, than if the parallel trader had set up a shop within the borders of the EU.

However, on this point an objection could be made from the side of the parallel importer. To establish exhaustion, it is necessary that the goods in question actually are sold on the market in the importing state. It may be argued that the parallel importer does not actually bring the goods into the EU, but that he after the sale transaction changes roles, to merely act as the customer's representative when he mails the goods across the Atlantic. However, that argument is not convincing. It makes no difference from the view of the customer or the rightholder in the importing state if the web-shop delivers the goods from the United States himself, or if it has an

¹¹⁵ This according to *Terrapin*, see section 4.4.2.

¹¹⁶ See section 4.8.

agreement with the Post Office or some other courier service company. In both cases, he gains from the reputation of the Tommy Hilfiger trademark without the authorization from the rightholder. Hence, the supply of goods through an Internet site should in the view of the author of this thesis not be differently dealt with than if the goods in question were imported prior to the marketing, like in traditional parallel trade.

Further problems might arise in connection with the Internet and trade. It might for example be difficult for the rightholder to detect parallel trade, especially if the unauthorized seller does not make striking advertisements and if the shipping occurs by ordinary mail. On the other hand, a rightholder can use specialized or general search engines to find web-sites containing his trademark.¹¹⁷ But Internet trade is fast. A web-shop can be established and advertised for within hours. If the parallel trader is lucky, the stock will be sold out before the owner of the trademark has had time to learn about the shop and react upon it. And if challenged, the web-shop can close quickly, only to open on another web-site under a different name. However, the author can not exemplify this pessimistic scenario, and does not know how plausible it is.

Internet advertising markets are a special case. On such sites, private sellers and buyers of different products are connected with each other. If the seller and buyer come from different countries, the sale might under circumstances constitute a trademark infringement. Sales through such sites are likely be extra difficult for the holder of the infringed trademark to detect, as the seller does not have to maintain a web-site of his own to place his offer.

To sum up, it is possible that the use of the Internet as a medium to connect sellers and buyers of tangible goods will lead to an increase in the cross-border trade of small batches of goods. The Internet provides an easy way for persons in low-price markets to connect with people in high-price markets to offer them cheap goods. The Internet might in this way provide the means of a new kind of parallel import, hard to fight, as the goods often are shipped in single packages using ordinary mail sendings. As a consequence, it might in the future be more difficult for companies to apply different prices on different locations.

5.2 Digital Products

5.2.1 A Few Characteristics

Before the examination of trademark exhaustion regarding online deliveries of digital products, a few characteristics of such products should be mentioned.

Digital products consist merely of information, or more technically, of bits, which is the technical term for the smallest non-dividable piece of information. Bits are often represented as series' of ones and zero's. When an amount of information is represented in that way, it can be read or used only by a computer or another information processing device. Digital products are most often marketed being stored

¹¹⁷ See for example "Tysk industri jagar pirater", DN 22 april, section IT p. 4.

on some physical carrier, such as a floppy disc or a CD-ROM, but when they are delivered over the Internet, they come without any physical elements. Only the bits are transmitted. When downloaded, the product is often stored on the hard drive of the customer's computer, but can also be stored on some other carrier.

Every personal computer contains devices to copy information from one memory to another, and it is very easy for the computer to copy information to other storage units, like floppy discs or CD-ROM's, but also to other computers if they are connected with each other through a network cable or over the Internet. The copies are perfect, impossible to tell from the original product, they can be made in a short time at virtually no costs, and there is no limit on the number of copies that can be made from one single master copy. The ease of copying is one of the fundamental differences between intangible digital products and traditional tangible products. Traditional goods are made of atoms, and are typically difficult to copy or reproduce. Even in those cases when it is easy to copy a tangible product, the copy will hardly be perfect. With traditional goods, the manufacturing costs are often a significant part of the total costs of the product, while a digital product is reproduced for free. However, the original digital product is often costly and demanding to produce. That is at least the case with software, which often demands months of developing, but also with most music, literature and other kinds of digitized intellectual property. Hence, the seller of digital products has to demand prices settled on a level to cover the developing costs, although that the copies are cheap in the making.

Today, as many computers all over the world are connected to the Internet, it is easy to transmit digital products from one location to another. Anyone with an Internet connection can spread a message or deliver a digital product to a global audience within a few moments. Therefore, when a product is marketed on the Internet, the whereabouts of the computer that actually stores it is unimportant.¹¹⁸ This is especially problematic from the point that intellectual and industrial property is differently protected in different countries. It is easy, unregardingly of the physical storage of the digital product, to establish a web-shop in a country with a low grade of protection, in the hope of being able to escape lawsuits from rightholders.¹¹⁹

It is possible to restrict the access to a place on the Internet. An easy and common way is to restrict the number of users by the use of passwords. Then only authorized persons can access the site. It is also partially possible to keep people from certain geographic areas out from an Internet site. As every computer connected to the Internet has a unique identification number (IP-number), that to some extent is geographically distributed, certain groups of IP-numbers can be denied access. However, as many computers have IP-number not reflecting their location, and there are ways to cover or falsely state an IP-number, the method is not fully effective.

¹¹⁸ Daniel Westman, "Rättspolitik på IT-området – ett diskussionsunderlag", Det IT-rättsliga observatoriets rapport 9/98, p 12.

¹¹⁹ For a discussion on countries providing low protection of copyright, see Peter Schönning "Internet and the Applicable Copyright Law: A Scandinavian Perspective", EIPR 1998 p. 45-46.

Nevertheless, large groups of Internet users can be correctly located through their IP-numbers.¹²⁰

Special problems arise when digital products are digitally traded on the Internet. Even the purchase of a digital product from its rightholder is somewhat problematic from a legal point of view. In such sales, the web-shop keeps a master copy, from which copies are made for the customers' downloads. In case the customer is not pleased with the product, he has, in some web-shops, the right to return the product against a refund of the payment.

But the literal returnation of the product would be pointless, as the seller still has got the master copy. Instead, such web-shops lets the customer certify that the product in question is erased from his computer. It is of course not possible for the rightholder to check that every customer really erased the product, and hence, he has to take the risk of unauthorized use of the product.¹²¹ It seems most reasonable to apply the same principle when a digital product is sold in second hand. Accordingly, the seller will have to erase the product from his own computer, after he has sold it.¹²² Otherwise, the seller did not sell his copy, but produced a pirate copy. Here, problems regarding evidence can be expected. What should a second hand seller do to free himself from the suspicion of being a pirate?

These characteristics of digital products – and of information in general – point to some of the large advantages of digital products, but from the view of its proprietor, they are also problematic. As soon as he sells a copy of his digital property, he will be at risk to see his market destroyed by counterfeit copies. Any customer can easily copy the product he has bought, and distribute it on the black market at a low price, or freely. Doing this, the customer can keep his own copy, which makes him ready to make pirate-copies again, one or several times.¹²³ If the consequence of the marketing of a digital product is the risk of a widespread pirate copying, it is understandable why much intellectual property is not sold as digital products.¹²⁴

The ease with which digital products can be copied is obviously a large obstacle to commerce in digital products on the Internet. The owner of some intellectual or industrial property, which can be the originator or someone that has acquired the rights from the originator, has an interest to sell a lot of copies, as he otherwise will not obtain full compensation for his investments. But the extensive pirate copying undermines his market. Accordingly, he has an interest to restrict or control the use of his product. Today, that control is in most cases exercised through legal means, for example license agreements, which seems not to be very effective. There are also technical means to control the use of digital products, the so-called "trusted systems".

¹²⁰ Interview 7.5.99 with Johan Blomé Svensson, Computer Science student at Lund Institute of Technology. My question to Johan Blomé Svensson was to what extent it is possible to restrict the access of computers located in a certain geographic area.

¹²¹ See for example in the help section of Ebar or Buyonet, www.ebar.com/ftime.html (17.5.99). See also Eva Fernquist "Köplagens tillämpning på handel med digitala produkter", section 5.4, in which she discusses the possibilities to return software after a purchase.

¹²² The Internet browser Opera may be transferred to a subsequent buyer, under such circumstances. See at www.operasoftware.com/ (17.5.99).

¹²³ Eva Fernquist "Köplagens tillämpning på handel med digitala produkter" section 4.1.3. and 5.4.

¹²⁴ See further Mark Stefik, "Trusted Systems", Scientific American 1997 issue 3. Published at www.sciam.com/0397issue/0397stefik.html (17.5.99).

The legal protection of digital products will be discussed below in section 5.2.3. If we turn to the technical protection, a number of methods are currently adopted.

5.2.2 Protection or Free Distribution

5.2.2.1 Protection

It is possible today to design software and hardware in such a way as to make unauthorized copying impossible. Such systems are called trusted systems. A trusted system is designed to follow certain rules, which defines the usage rights of a certain digital product. It can also specify the costs, the terms and the conditions under which a digital product can be bought or used. A trusted system can take different forms. Some are designed to protect digital books or pieces of music by making them impossible to copy; others direct trusted servers that are selling digital products. A trusted system relies on complex encryption and recognition systems, but the result is simple: distributors can sell digital products without risking any unauthorized copying or use of them. Trusted systems can be constructed to give different levels of protection. More valuable products can be protected so that unauthorized dispositions are impossible, while other systems could restrict themselves to the “watermarking” of products or dispositions, making them traceable.¹²⁵ In April 1999, two companies, Microsoft and IBM both released software including built-in management of property rights, for the playing of media and sound files. The future will show, whether trusted systems will be implemented in other areas.¹²⁶

Another way to protect software from unauthorized copying is to construct it in such a way that the customer will be in need of technical support. Support services are necessary especially for inexperienced computer users, or by the implementation and use of highly specialized software. Of course, support is not available when the software is bought from a pirate, or otherwise used without authorization. Nor will the user of unauthorized software receive bugfixes or software updates. An additional way for a proprietor of intellectual or industrial property to hinder unauthorized copying, is to use search engines in order to find Internet pirate shops.¹²⁷ After having found a pirate, the owner can react upon the unauthorized selling of his product. However, the methods currently used to protect against pirating seem to be ineffective. Estimations show that 40% of the software used worldwide 1997 was pirated,¹²⁸ The music industry also suffers from extensive pirate copying.¹²⁹

5.2.2.2 Free Distribution

Other software strategies rely on free distribution. So-called shareware is distributed freely to the users. Some can be copied without restrictions, while other shareware originators are using exclusive distribution channels. The license agreements of

¹²⁵ Mark Stefik, *ibid.*

¹²⁶ See DN 22 April, “*Nya fronter i muikkriget*” and “*IBM vinner anhängare*”. See also www.microsoft.com/ and www.ibm.com/ for further information. (17.5.99)

¹²⁷ See DN 22 April, “*Tysk industri jagar pirater*”

¹²⁸ According to a report from Business Software Alliance. “*1997 Global Software Piracy Report*” published at www.bsa.org/statistics/ (17.5.99).

¹²⁹ “*Tonsättarna rättslösa på nätet*” DN 20.04.99

shareware programs does not demand payment from the user before he starts using it, but in many cases the program contains built-in restrictions that are lifted only after a payment. Other programs are free to use for non-commercial purposes, or completely free. Basically, those distributing their software as shareware rely on voluntary payment from content users.¹³⁰

There is also the open-source software, that is licensed for free, and open to changes. During its development, software is handled as source code, in which the program is open to changes, and the technical solutions of the software engineers are visible. Most programs are compiled before distribution, into a form that is non-comprehensible for humans, readable only by computers. In that way, technical solutions can be kept secret, and the originator can be sure that the program is not changed and distributed in a corrupt version. The source code is then closed.¹³¹ However, some software developers find it better to distribute their software for free and with an open source code, which makes it possible for anyone to change it.¹³² Why is this? Many of them do not believe in intellectual property rights for ideological reasons, but more important is that open-source development of software in several cases has proven to be an effective way of producing high quality products on which money can be made. Distribution of the source code is free in the sense that no payments are required, but both the distribution and changes of the code is regulated through license agreements. Open-source software development is often project based, and some software engineers dedicate their spare time to open-source development of software, which today is an important movement in software production. The commercial side of open-source can be exemplified by two companies. Red Hat Software lets their programmers work with the development of the widespread open-source operating system Linux. As Linux can be downloaded from the Internet for free, the company does not cover its costs by sales, but earns good on support services.¹³³ In 1998 Netscape Communications Corporation let their Internet browser Netscape Navigator be an open-source project on two grounds: that they believed open-source to be an superior development method, and to give their browser product a better position on the market.¹³⁴

There are also other kinds of freely distributed digital products, for example digital books or music given away for promotional purposes. Many web-shops provide some free downloads to let the customer try the product.¹³⁵

¹³⁰ See www.asp-shareware.org/. WINZip by Niko Mak computing Inc. (www.winzip.com/) and Doom by Id Software Inc. (www.idsoftware.com/) are two widespread shareware programs. (the sites accessed 17.5.99)

¹³¹ Compiled software can be “cracked” into, and changed. That is however comparingly hard. Through so called reverse engineering some software can be read by humans.

¹³² Open-source software is explained in short by the open-source organization as following: “Open source promotes software reliability and quality by supporting independent peer review and rapid evolution of source code. To be certified as open source, the license of a program must guarantee the right to read, redistribute, modify, and use it freely.” See further at www.opensource.org/osd.html (17.5.99).

¹³³ www.redhat.com/ (17.5.99)

¹³⁴ See www.mozilla.org and www.mozilla.org/NPL/FAQ.html (17.5.99).

¹³⁵ See for example www.onlineoriginals.com/ or www.goodnoise.com/ (both accessed 17.5.99).

5.2.3 License Agreements

The intellectual and industrial rights protection of digital products is in most cases complemented by a license agreement, which typically forbids the user to make more copies than necessary to use the product. Additionally, many licenses prevent the licensee from distributing the product to a third party. License agreements are very useful from the view of the rightholder, as they clarify the rights of the licensor and the licensee. Thus they make the situation more clear than if the parties relied solely on their legal rights. In case such a license agreement is used, it is affecting the possibilities to carry out parallel trade. A few comments on the impact of them in that area will be made here.¹³⁶

License agreements are usually standardized, meaning that the customer will have to accept the terms or refrain from the buy. There are a few general legal rules connected with standardized contracts. A basic rule is that the terms of the contract are valid although one of the parties (the customer) might not have read it through. That is practical, as it is far easier to base the interpretation of the agreement on the written text than on the alternative – the subjective intentions of the parties. On the other hand, such an approach might be inappropriate when the contract includes terms that are surprising and unfair for the customer. In such cases regard must be had to how easy it was for the customer to spot unfair contract terms. If it somehow was highlighted by the seller, it is more likely that the customer will be bound by it, than if it was hard to find.¹³⁷

In Internet trade, it is common that the terms are presented somewhere on the web-shop's site. As a web-site can be a pedagogical medium, the seller has an opportunity to effectively highlight the crucial terms to the customer before the buy. Compared with a paper document, a web-site can be far more vivid, as many shops require the customer to click on a certain link or to check a box to affirm that he agrees to the contract.¹³⁸ Some Internet shops do not present the terms of the license agreement to the customer until after the purchase. In such cases, the basic rule is that the customer should be bound by the terms if they on grounds of earlier business contacts or on other grounds can be regarded as implied in the agreement.¹³⁹ This might also apply to terms that are present on the shop's web-site, but difficult to find.

In case the customer's relation to the seller is that of a consumer, there might be reasons to give him more protection than a professional would have. As it can be expected that a professional is aware of the trade custom of his certain branch, it is more likely that he will be bound by standardized agreements expressing the trade custom even if they were not properly presented to him before the buy. That is different with consumers, who can not be expected to have specialized knowledge about the trade custom of different business branches. On the other hand, it could be argued that certain terms of a typical license agreement are so commonly known that

¹³⁶ See for example Fred M. Greguras "1998 Trends in Software Licensing and Legal Protection for Software" published at www.fenwick.com/pub/1998_trends_in_software_licens.htm, accessed at 10.6.99.

¹³⁷ Christina Hultmark, "Elektronisk handel och avtalsrätt", p. 72-74.

¹³⁸ Christina Hultmark, "Elektronisk handel och avtalsrätt", p. 72-74.

¹³⁹ Axel Adlercreutz, "Avtalsrätt II", 4:th edition, p. 81.

they should be binding for consumers even if they were not presented before the buy.¹⁴⁰ Maybe the prohibition on copying of digital products could constitute an example of that, as such terms can be found in most license agreements.

According to the argumentation in this section, it is likely that most license agreements will be found enforceable, which means that most customers agree on not to sell the product in question in second hand. If he still sells the product to a third party, he has broken his contract with the rightholder, and might under circumstances be liable to damages. This means that if the customer would continue selling products to third parties, the licensor will probably be able to find legal means to stop the sales. Moreover, if it shows that some part of the rightholder's distribution net is selling digital products to parallel traders, it is plausible to think that that part of the distribution net could be checked.

Does this mean that license agreements prevent legal second hand marketing of digital products? The answer is probably no, at least from a trademark rights perspective. The reason is that the license agreement is a contract between the rightholder (or his representative) and his customer. A subsequent buyer of a licensed product should not be bound by that contract, as he never was part of it. Further, if a license agreement could bind subsequent buyers, then trademark exhaustion would be useless, as all legal second hand trade then could be prevented at the discretion of the rightholder, by the adding of license agreements. Here, a comparison with the *Silhouette* case can be made. In that case, the company *Silhouette* had an agreement with the buyer of its spectacles, stating that they should not be sold outside Bulgaria or the former USSR. That agreement, (only briefly mentioned by the Court), is similar with the license agreements described above.¹⁴¹ In the *Silhouette* case, the distribution agreement did not hinder the subsequent buyer *Hartlauer* from marketing the spectacles in Austria, and neither should, in the view of the author of this thesis, a license agreement hinder a third party from marketing digital products, have they come into his possession.

5.2.4 Examples

Digital products are well suited for Internet trade, as a purchase is very easily completed. An example of a software Internet store is the Swedish undertaking *Buyonet*.¹⁴² *Buyonet*'s products can be instantly downloaded, and the payment is made on the customer's credit card. For some of the products, like Microsoft Windows 95 and IBM HomePage Print, *Buyonet* has the distribution rights only for North America, which means that the shop do not let customers from other countries buy that software. *Buyonet* is not the only shop maintaining a geographical demarcation of its sale area. The US companies *Buydirect.com*, *eBarn.com* and *Beyond.com* have similar policies.¹⁴³ Others, like *Downloadsuperstore.com* and *Digitalriver.com*, does not inform about any geographical sale restrictions on their web-sites.¹⁴⁴ The companies that are maintaining restrictions are pointing at the

¹⁴⁰ Adlercreutz, *ibid.*, p. 67, 69.

¹⁴¹ For an analysis of that agreement, see Thomas Hays, Peter Hansen "Silhouette is Not the Proper Case Upon Which to Decide the Parallel Importation Question", *EIPR* 1998 p. 281

¹⁴² At www.buyonet.com/ (17.5.99).

¹⁴³ To be found at www.buydirect.com/, www.ebarn.com/ and www.beyond.com/

¹⁴⁴ To be found at www.downloadsuperstore.com/ and www.digitalriver.com/ (accessed 17.5.99).

producers marketing policy or on US export restrictions on strong encryption techniques as reasons.¹⁴⁵

Some software products have non-distribution clauses in their license agreements, while others permit distribution. Opera Software is an example of a company that sells its product, the Opera Internet browser, under a license agreement permitting distribution. Opera Software has nothing against second hand trade in its product as long as transfers are made on a permanent basis, and no copies of the software are retained by the selling party.¹⁴⁶

Products that have significant non-digitized elements might be less attractive buys when delivered digitally. Among such products are books and music recordings. On the other hand, a digital product can be acquired much faster when downloaded than when bought in physical form. Online Originals is a publishing company that publishes and sells books solely on the net.¹⁴⁷ The books are delivered in common standard formats readable by most personal computers. They are as cheap as ordinary pocket books, and are delivered to the customer's e-mail account after the payment. The books come with usage restrictions, however, only visible after the purchase. According to a copyright text at the first page, the purchaser is not authorized to sell or otherwise distribute it to a third person. Two other Internet publishers, Boson Books and Hard Shell Word Factory instead seems to rely solely on copyright laws.¹⁴⁸ (Boson Books also provides with free downloads of "oldies", books whose copyright has expired. As they are not protected by copyright any more, Boson's trademark seems to be the only obstacle to the free distribution of these books.)

Despite the popularity of downloadable music files today, there are not many Internet stores selling such products. A large part of the downloadable music on the Internet is pirated. An explanation could be that sound information today can be compressed as MP3 files. MP3 is a format that can make music files small enough to be easily transmitted, without sacrificing the sound quality. Nor are there any technical obstacles to the copying of an MP3 file. In the light of this, it appears that the music industry finds it better to turn its eyes towards trusted systems.¹⁴⁹ One of the shops that nevertheless sell music as MP3 files is Goodnoise Corporation. Goodnoise does not use license agreements, but, according to its web-site, seems to rely solely on their legal intellectual and industrial property rights.¹⁵⁰

These examples, albeit few, illustrates that most digital products are not sold without some kind of license agreement. Further, trade in music and books on the Internet does not seem to be as extensive as software trade, a situation that, however, might change, maybe with the introduction of trusted systems.

¹⁴⁵ See for example www.ebarn.com/ftime.html (17.5.99).

¹⁴⁶ WWW.operasoftware.com/ (17.5.99).

¹⁴⁷ WWW.onlineoriginals.com/ (17.5.99).

¹⁴⁸ To be found at www.cmonline.com/boson/ and www.hardshell.com/ (both accessed 17.5.99).

¹⁴⁹ "Musiken exploderar på nätet" DN 19.04.99 and "Fler nya musikspelare" DN 29.04.99

¹⁵⁰ WWW.goodnoise.com/ (17.5.99).

5.2.5 Exhaustion

As showed above, trade in software, digitized books, music and other products consisting of information have partially moved over to the Internet. There are significant differences between digital products and traditional products both in their nature, and in how they are traded. Further, it has showed that license agreements seem to be no absolute obstacle to second hand trade in digital products, even if they can give the first hand buyer or distributor incitements not to transfer products to parallel traders. As second hand trade in digital products thus is possible, it appears that the exhaustion doctrine could be applicable on them. In this chapter it will be examined how the EC-law exhaustion principle would look applied on trade in digital products.

Trademark exhaustion has developed together with other industrial and intellectual property exhaustion.¹⁵¹ Thus, as there is no community legislation that in particular covers trademark exhaustion in connection with Internet trade, the existing community provisions regarding copyright exhaustion might be a helpful starting point for filling in the gaps. A harmonization of aspects of copyright protection is under way. In May 1999, an amended proposal for a directive on the harmonization of certain aspects of copyright and related rights in the Information Society was issued.¹⁵² The directive is intended to complement a few directives harmonizing certain aspects of copyright.¹⁵³ However, an examination of the directives and the proposal leads to few conclusions.¹⁵⁴ The Commission's view that deliveries of digital products are to be seen as services is confirmed, most clearly in a recital of the proposed copyright directive. The possibility to, despite this view, treat digital products as goods has already been discussed in section 2.2.

5.2.5.1 Marketing by the Rightholder or With His Consent

Just as Internet trade in tangible goods, Internet trade in digital products tends to be international. As digital products do not have to be shipped physically, there will, from the view of the customer, be no difference between a purchase from an undertaking in his own country and a purchase from abroad. The Internet thus provides the prerequisites for global competition on equal terms between sellers of digital products.

However, trademark protection is still national, which means that there will be significant risks of trademark infringements if two undertakings are marketing products on the Internet using trademarks likely to be confused with each other. If one of the companies is delivering its products into a country where the colliding trademark is protected, he will be infringing that trademark, with the consequence that

¹⁵¹ See section 4.0.

¹⁵² COM (1999) 250 final, (21.5.1999).

¹⁵³ 91/250/EEC on the legal protection of computer programs; 92/100/EEC on rental right and lending right and on certain rights related to copyright in the field of intellectual property; 96/9/EC on the legal protection of databases. See COM (1996) 586 final, (20.11.1996), Follow-up to the green paper on copyright and related rights in the information society, p. 14.

¹⁵⁴ The directives confirm that the exhaustion principle is valid regarding copyright: article 4(c) computer programs directive, article 9(1) of the rental right directive, article 5(c) of the database directive..

the trademark proprietor in the importing country will have the right to stop the deliveries. It was established in the Terrapin and Ideal-Standard cases that this basic trademark principle should apply also within the common EU market, and there seems to be no reason why it should not be applied on trade in digital products.¹⁵⁵

Luckily enough, the shops will not have to manually supervise the sale orders, as there are technical means to restrict server access to the geographical areas selected by the shop. The technical means are only partially effective, as persons with atypical IP-numbers can slip through the restrictions. However, the customer can also be required to state his residence before the buy. If he lives in a country where the trademark in question is held by someone else than the shop, the shop can be programmed not to process the order. Despite such measures, it is likely that some persons will be able to slip through, for example by stating an incorrect residence. If they are not too many, they could probably be left without regard, as it would cost a web-shop too much time to manually check all orders. To hold the owner of the infringing trademark responsible in such a situation would be of no use, as he has done everything that is in his powers to hinder the sale.¹⁵⁶ Nevertheless, to the extent this technique is effective, it can also be used to maintain branding strategies. By their use, a product can be marketed to diversified prices at different locations, without undermining the market in high price areas.

What if a digital product becomes downloaded to a country where the seller never intended to market it? Will it, despite that, be exhausted in the importing country? And, what if a customer takes advantage of the lapses in the geographical access restraints of a shop, and, for example, downloads a product to Europe that was meant to be put to sale only to US residents? As the Court consequently has said, exhaustion occurs only on the market on which the product is put into circulation with the consent of the rightholder. But how is that to be interpreted in this context?

A possible departure point in the discussion would be to let the seller bear the risk of exhaustion of his trademark rights. Someone selling digital products on the Internet can hardly be unaware of the fact that a web-shop is possible to reach from all over the world. If the seller does not want to take orders from member states in the EU, it is easy for him to express that on the web-site of his shop, or even install technical access restraints. But if he does not take such steps, he should have to accept exhaustion on the common market, if his products are purchased there. A possible objection to this from the seller's side could be that *he* never took any steps to market his product in the disputed country. In contrary, the customer was the active party when searching for and picking him out, a foreign seller. Furthermore, the seller will often lack sure information on the location of the customer. Under such circumstances, why should the seller have to take the risk of exhaustion when he is in no position to find out from where his customers are contacting him? This objection is not convincing, however. It does not take into account the ease with which a seller can

¹⁵⁵ See section 4.4.2.

¹⁵⁶ It seems plausible to argue that if the IP-number of a customer is pointing in the wrong direction, and the customer is stating an incorrect residence, the shop should not be responsible for delivering the product into a country where its trademark "collides" with a trademark hold by somebody else. In such a case, the web-shop has few possibilities to find out the correct domicile of its customer, and, from the web-shops point of view, there might lack reasons to suspect anything to be wrong.

exclude customers from certain countries. Either he can install technical access restraints, or he can design his web-appearance in a way that clarifies where he wants to market his products. He can also design his web-shop not to process orders from certain countries.¹⁵⁷

If the seller has taken these steps to exclude customers from certain countries, it appears plausible to argue that he should not be held responsible for a customer that circumvents the restrictions by falsely stating his residence. The situation could be compared with a (tangible) mail sending from a post-order retailer in the US. If a customer orders the goods to an address in Germany, but has agreed with the Post Office to have his mail rerouted to Russia, then the goods should be exhausted in the EU, not in Russia. In this example, the customer gave the seller (intentionally or not) incorrect information regarding his location, on which the seller based his decision to deliver the good. As the seller has no possibility to check if the address is correct, he should not bear the risk of exhaustion.¹⁵⁸

This proposal, that the seller should bear the risk of exhaustion on the common market, if he does not take steps against the marketing there, takes into account the differences between a web-shop and a traditional shop. A shop on the Internet, especially one that markets digital products, is equally accessible all over the world. From the customer's point of view, a web-shop established in his hometown is as nearby as a shop established on another continent. Hence, it is natural for the customer to search for and pick out the best deal from the global market of digital products. The seller can hardly be unaware of this, and should accordingly take steps if he does not want his products to be sold or his trademark rights to be exhausted in the EU. Additionally, it is easy to collect evidence about the appearance of a web-shop, which hence makes that a practical criterion when establishing if a seller has consented to sell a product on a certain market.¹⁵⁹

Furthermore, the proposal is backed up by parts of the ECJ's argumentation in *Ideal-Standard*. The case evolved around the trademark *Ideal-Standard*, owned in Germany by *Ideal-Standard GmbH*. The Court let the German company stop the importation of products produced in France bearing its trademark. In its argumentation the Court stressed that when a company has the possibility to exercise control over the manufacture and quality of the marketed goods, it cannot oppose the exhaustion of low-quality goods that it has manufactured, on grounds that it did not actually controlled the production.¹⁶⁰ It appears that the argumentation could be transferred to the proposal under this heading, that a web-shop selling digital products delivered over the Internet should bear the risk of exhaustion on the common market if it does not use its possibilities to exclude EU member states residents from its customer stock. In both situations, the possibility of control lies at the hand of the trademark owner.

¹⁵⁷ Compare Patrik Lindskoug "*Vissa frågor rörande internationellt privat- och processrättsliga regler vid konsumenthandel på Internet*", to be published in JT nr. 4 1998/1999 p. 63. Compare especially section 6.4.3 of the article, which, from a private international law perspective discusses where a product is marketed.

¹⁵⁸ Compare Patrik Lindskoug *ibid* p. 63.

¹⁵⁹ Patrik Lindskoug *ibid*. Compare also www.Buyonet.com, that excludes customers from other locations than north America from buying some of its products. (Section 5.2.4.)

¹⁶⁰ See section 4.4.4.

Hence it could be argued *ex analogia* from the Ideal-Standard case that if the trademark owner does not use his instruments of control, he should bear the responsibility, by the risk that his products get exhausted in the EU.

What criteria should then be applied when establishing if a web-shop is consenting to market its products on the common market? The best thing is of course if the shop expressively states the target country on its web-page. However, the over all appearance of the web-shop should also be looked at. Among other things, especially the language of the shop and the currency in which the payment is to be fulfilled could be taken into consideration.¹⁶¹

An alternative solution to the problem discussed under this heading, could be to take the view of the seller (the trademark proprietor or his representative), as his consent is crucial to exhaustion. Then, the product would be exhausted in the country whereto the seller intended to transmit it, not in the country where it actually ended up. This solution is, however, impractical from the viewpoint that the seller's subjective intentions would have to be ascertained in order to establish where a digital product has been exhausted. It is hard to collect evidence on such intentions, especially as the seller is likely to be one of the parties in a dispute whether the trademark is exhausted. Hence, it is the view of the author that this solution is less likely to be adopted as EC-law.

In this section it was argued that the trademark proprietor should bear the risk of exhaustion in the EU if he does not take steps against that. However, the question remains whereto a certain digital product actually is delivered. Only after that question has been answered, it can be established whether the trademark rights of that product has been exhausted on the common market, or not. That question will be discussed in section 5.2.5.4.

5.2.5.2 Objections to Exhaustion

An objection to the exhaustion of licensed products can be derived from the fact that the license includes a non-distribution clause, (in case it does). If the license agreement includes such a clause, the rightholder has explicitly objected to any subsequent sales of the product in question, and he might claim that he never consented to the circulation of that product on the common market.

To understand this objection correctly the argumentation in section 5.2.3. should be recalled. It was argued in that section that a non-distribution clause could not in itself hinder the lawful parallel trade of a product sold under it. The reason being that subsequent buyers of that product are not parts of the agreement, and, hence, are not bound by it. In this section, the non-distribution clause is looked upon from another view, namely: does a non-distribution clause imply that no consent – in the sense of the Ideal-Standard case – was given to the putting of the product in question on the common market?

¹⁶¹ Patrik Lindsoug *ibid.*, and section 6.4.3.

The objection might appear to be supported by the ECJ, as it, for example in *Ideal-Standard*, thoroughly has stated that the consent of the proprietor of the trademark in question is crucial to the exhaustion of a trademark right. Nevertheless, the prerequisites of consent have probably been met also when the proprietor has marketed his products under a license agreement including a non-distribution clause. First it should be mentioned that if the trademark proprietor has sold the product (even if under a non-distribution clause), he has consented to put the product on the market in a straightforward sense of the wording. The Court's considerations in *Ideal-Standard* supports the view that this straightforward interpretation should be chosen. In *Ideal-Standard*, the Court put its emphasis on the trademark proprietor's control over the quality of the goods, as it wanted to protect the trademark's function to guarantee the commercial origin and quality of the products in question. That function would not be questioned by the exhaustion of the trademark on a product protected by a non-distribution clause. If a rightholder takes the position suggested here, he is seemingly trying to protect himself not only from counterfeit use of his trademark, but also such use of it that does not disturb the trademark's function as a guarantee of the commercial origin of the product. The wording of the trademark directive supports this view. Article 7 of the trademark directive shows that the EC-law does not protect trademark proprietors from others' use of their brands once the goods is "*put on the market*", unless there exist "*legitimate reasons*" for doing so. The wording of the directive hence suggests that the mere putting on the market of the product suffices for exhaustion. The wording "*legitimate reasons*" seems to refer to the state of the products in question, as it is exemplified with impaired or changed goods, and therefore appears to be protecting the quality and the commercial origin of the goods. Finally, to let the lack of this kind of consent hinder the exhaustion of rights would be to give the rightholder an instrument with which he could turn off trademark exhaustion when he likes to, simply through the introduction of non-distribution clauses in his license agreements.

5.2.5.3 Marketing by Others

As we have seen, the trademark rights of digital products seem to exhaust at the sale, just like with traditional tangible goods. Accordingly, there should – theoretically – be no obstacles for others to trade the product. However, there are some practical problems connected with trade of digital products. Before their examination, a few more details on the exhaustion principle's impact on digital trade will be discussed.

As the Advocate General Jacobs said in *Sebago*, only those products actually put on the common market have been exhausted there, not other products of the same kind.¹⁶² That must be valid also for digital products. If for example 100 copies of some software have been sold on the common market, a parallel importer would not, on grounds of the exhaustion of the first 100 copies, be allowed to import another 100 to sell.

In *Dansk Supermarked*, the ECJ said that if a company chooses to sell goods of different quality under one trademark on the common market, the company will have

¹⁶² *Sebago Inc. and Ancienne Maison Dubois et Fils SA v. GB-Unic SA*, Case C-173/98 (not yet decided).

to accept that the goods of lower quality is imported into the country where he is marketing the high quality goods.¹⁶³ The judgement relies on the rule of free movement of goods on the common market. The facts in Dansk Supermarked resemble of certain circumstances in the computer software market. Software producers are probably not releasing different versions of their computer programs on different locations, but they usually develop their software over the time, so that a program that is one year old in many cases comes with less features or is of poorer quality than a newly released copy. The first version of a computer program is usually named 1.0, then follows 1.1, 1.2 etc. When the program undergoes more extensive revisions, the counting will continue from 2.0. Suppose that a company has bought a number of copies of a computer program in, let's say, version 2.0. After the 3.0 version has been released, that company wishes to sell off its 2.0 software, and markets them at a low price. In Dansk Supermarked the Court confined itself to a referral of its earlier case law. The goods, china sets, were marketed with the consent of the trademark proprietor, and thus the subject-matter of the trademark in question was protected. These conditions are fulfilled in this supposed software case. The situation could also be compared with how the automobile industry works. Most cars are released in new models every year, and the release of a new model is no ground for prohibiting people from selling their old ones.

5.2.5.4 The Location of the product

Trademark protection is national, and trademarks on products – including digital products – can only be exhausted in relation to the legal system of some particular country. If the product was marketed on the common market, its trademark is exhausted there, but if it was first marketed outside the EU and then imported by a parallel trader, the trademark is not exhausted on the common market. However, as the Internet is a global medium, it appears to be difficult to decide where a certain digital product is located, geographically. Where was the product delivered in the first place, - when it was sold by the rightholder? If it is traded in second hand, from where, and what destination is the product to be delivered? Before the EC trademark law can be applied on a certain product, these questions must be answered.

The difficulties to decide the location of a digital product are the consequences of the differences between traditional tangible goods and digital products. One of the characteristics of digital products is that it is not more difficult to transmit them between continents than it is to transmit them to a location nearby. The same applies for access or use of digital products. From a user's point of view, it is not more difficult to access a product that is stored faraway, than one that is stored locally. Hence, it is plausible to argue that the location of a digital product should not be decided based on the same argument used when dealing with tangible products. In some cases, when the purchaser downloads the product to his local computer, stores it on his local harddrive, and only uses it there, it appears that the digital product should be regarded as located in the country in which this occurs. In other cases, however, the question seems harder to solve.

¹⁶³ See section 4.7.

As the problem did not exist before the birth of the Internet, and hence is comparably new, it has not yet been solved in the context of the EC trademark law. However, some conclusions may be drawn *ex analogia* from other areas of law. First, it will be examined whether there is any guidance on this matter in the current EC-law.

Legislation

The trademark directive appears to give no guidance on this matter, as it does not address the new legal environment provided by the Internet. Neither appears the current or proposed legislation on copyright to be of any help.¹⁶⁴ These directives only discuss exhaustion when the digital product is sold on a tangible medium. When it comes to Internet transmissions of such products, the directives argue that such transmissions are to be regarded as services, and the question of exhaustion hence does not arise.^{165 166}

In addition to the already mentioned legislation, there is a proposal for a directive on certain legal aspects of electronic commerce in the internal market.¹⁶⁷ This proposal includes rules on where the provider of an information society service should be established.¹⁶⁸ This rule of establishment is based on ECJ case law, and refers to the nature and stability of the economic activity of an undertaking rather than to technology, which makes it less interesting for the problem of the location of digital products.¹⁶⁹ Crucial, however, is that the rule in the proposed directive specifies the location of the delivering company, not the single product. (Perhaps because the single product is regarded as a service by the directive.) As it is obvious that the location of a delivering company can be separated from the delivered products, the rule of the directive appears to be of no help with best regards to our problem.

Case Law

In the case *Konsumentombudsmannen vs. De Agostini and TV-shop*, the ECJ has addressed aspects of international electronic communication within the EU.¹⁷⁰ The case dealt with the question of whether a member state (in this case Sweden) can take actions against television advertisements broadcasted from another member state (the UK).¹⁷¹ After having examined the “television without frontiers”-directive and articles 28 (30) and 49 (59) of the treaty, the Court allowed the Swedish authorities to take the abovementioned actions, as long as they did not prevent the retransmission of the broadcasts from the other member state as such. The ruling is important in that it decides the scope of the transmitting state principle, as laid down in the television directive. That principle relies on home country controls of television broadcasts, to hinder member states from impeding the reception and retransmission of television

¹⁶⁴ See footnote 153 and 154.

¹⁶⁵ See especially recital 19 in the proposal for a directive on certain aspects of copyright and related rights in the information society, COM (1999) 250 final, p. 15.

¹⁶⁶ See section 2.2 for a discussion on whether digital products are goods or services, and if that matters for the purpose of this thesis.

¹⁶⁷ COM (1998) 586 final (18.11.1998).

¹⁶⁸ Article 2(c), explained on p. 20-21 on the proposal *ibid*.

¹⁶⁹ Case C-221/89 [1991] ECR I-3905, paragraph 20. See also the proposal *ibid* p. 20-21.

¹⁷⁰ Joined cases C-34/95, C-35/95 and C-36/95, *Konsumentombudsmannen v De Agostini (Svenska) Förlag AB and TV-Shop i Sverige AB*. [1997] ECR I-3875.

¹⁷¹ It was also asked whether the “television without frontiers”-directive (89/552 EEG, changed through 97/36 EG) precludes the application of a national law prohibiting advertisements directed at children.

emanating from another member state. In *De Agostini*, the ECJ choose a narrow interpretation of the transmitting state principle. In short, it covers the transmission as such, but not the contents of it.¹⁷²

The “television without frontiers”-directive excludes in its first article the Internet from its field of application, but it has been proposed that the transmitting state principle nevertheless could be applied on the Internet *ex analogia*. If so, the proposal goes, content on the Internet would be judged according to the law of the state from which it emanates or is “transmitted”. The advantage would be that every Internet resource would be checked only by one of the member states.¹⁷³ However, Carlén-Wendels shows that the reasons not to introduce a transmitting state principle on the Internet seems to be stronger than the reasons in favor of it. First, Carlén-Wendels refers to the reasons why the transmitting state principle was adopted on television broadcasts. The rules governing television broadcasts in the EU are comparatively similar. Further, television broadcasting companies are large, they are easy to recognize, and it is easy to find out where they are established. Accordingly, the transmitting state principle is fairly easy to apply on television. On the Internet, however, the case is considerably different. Hence, the considerations leading to the introduction of the principle on television broadcasts are not transferable to the Internet.¹⁷⁴

Furthermore, in *De Agostini*, the Court choose to give the principle a very narrow interpretation, as it was set only to cover the rules on the transmissions as such, not the content of them. Accordingly, if a transmitting state principle based *ex analogia* on *De Agostini* would be introduced on the Internet, it would not cover the transmitted content. However, on the Internet, it is precisely the content that needs regulation, since the rules governing the transmissions as such are uninteresting in comparison. It is of course possible to advocate the introduction of a transmitting state principle on the Internet, despite that such a view has not even been fully adopted on the more homogenous field of television broadcasts between EU member states. However, it appears that the result would be a lack of foreseeability in legal matters as it would be difficult to decide the origin of a certain “transmission”.¹⁷⁵ It further seems to be very unpractical to introduce a transmitting principle only in the EU, if the rest of the world would follow other principles.¹⁷⁶

Conflict of laws ex analogia

As the Internet has made it easier for people and companies to interact with each other internationally, the problems of *conflict of laws* has been actualized in the doctrine concerning the Internet. The problem of choosing which law and jurisdiction that should be applied on a certain digitally stored information seems to be similar to the

¹⁷² The Court allowed the Swedish authorities to apply its marketing laws on the broadcast. Consequently, the content of the broadcast can be checked by the receiving member state. See Ulf Bernitz “*TV-reklam och räckvidden av svensk marknadsrätt*”, JT 1997-1998 p. 480-481, and Carlén-Wendels “*Nätjuridik – Lag och rätt på Internet*” p. 48-50.

¹⁷³ See for example Richard Åkerman, Åsa Thunman “*Juridiktions- och lagvalsproblem på Internet*” JT 1997-1998 p. 446-447. They propose that the transmitting state principle should apply on the Internet regarding jurisdiction and choice of law.

¹⁷⁴ Carlén-Wendels “*Nätjuridik - lag och rätt på Internet*” p. 48-50.

¹⁷⁵ Compare with the rest of this section.

¹⁷⁶ Carlén-Wendels, *ibid* p. 48-50.

problem of establishing the legal whereabouts of it for the purpose of trademark exhaustion law. However, it should be kept in mind that the areas of *conflict of laws* and *trademark exhaustion law* are different in their conception, and that they are intended to serve different purposes. Hence, it is important to be careful, and not to jump to conclusions.¹⁷⁷ Further, the field of *conflict of laws* is not one homogenous entity of rules, but consists of the international aspects of many different areas of law, like criminal law, marketing law, intellectual property law etc. Each of these areas follow different principles.¹⁷⁸ Nevertheless, argumentation borrowed from *conflict of laws* might be useful, and could perhaps be applied *ex analogia* on the problem discussed under this heading.

When the jurisdiction concerning information stored on a certain computer memory is to be established, it has been argued in the field of criminal law that the physical location of the computer memory should be of relevance.¹⁷⁹ The advantage of such a view is obvious: every piece of information would fall under one single jurisdiction, easily established. It is, however, plagued by a number of problems. As information is easily transferred on the Internet, the placing of a certain information on a computer memory is likely to be determined by the availability of storage capacity and price, rather than by geographical nearness. These factors appear random and irrelevant from a *conflict of laws* perspective. Additionally, if the geographical location of the computer memory would be of legal relevance, the choice of storage location would be influenced by one further factor, namely to avoid storage in countries with unfavorable legal rules. In the end, it is very easy to move content from one storage place to another. Apparently, there are reasons not to take the whereabouts of the computer memory as a reference point in the area of *conflict of laws*.¹⁸⁰ However, it appears that the method to some extent could be applied on the field of trademark exhaustion. In some cases, the physical location of the computer memory seems to be a good choice when deciding the legal whereabouts of a digital product. Take for example the situation of a typical. When a private person downloads a digital product to his own computer, maybe located in his own home, the location of that computer appears to be the natural choice when deciding to which country the product is delivered. However, a slight change of the scenario changes the applicability of the method – many products are delivered by e-mail, and if the purchaser is using a web-mail service for his electronic correspondence, his e-mail is stored on a memory by the choice of the mail service provider. The location of that memory is likely to lack relevance from a trademark perspective, and thus, the location of the digital product would appear random if it was based on that memory's whereabouts. The problems with the choice of the computer memory for the purpose of establishing the whereabouts of a digital product seems to be more troublesome with regards to companies trading digital products. If the company stores them on a local memory, its

¹⁷⁷ The different purposes of conflict of law and the rules on the location of products from the view of trademark exhaustion can be illustrated by an example: The fact that a court in country A has jurisdiction over a digital product does not hinder that country from recognizing alternative jurisdiction in foreign countries. However, from the view of trademark exhaustion, one digital product must be regarded as located in one country only. Hence, legal reasoning concerning the whereabouts of the product must differ between the two areas of law.

¹⁷⁸ See Thomas Carlén-Wendels "Nätjuridik - lag och rätt på Internet" p. 41-42.

¹⁷⁹ Bogdan, "Gränsöverskridande förtal i Cyberspace" SvJT 1998 p. 7.

¹⁸⁰ Thomas Carlén-Wendels "Nätjuridik - lag och rätt på Internet", p. 45-46.

location might be a good point of reference, but if it outsources its storage function, the products could be located anywhere. Digital products can easily be moved around worldwide, and the physical distance to a server does not influence the possibilities to access it. The decision to outsource storage capacity is likely to be based on considerations regarding for example costs, which has little relevance from a trademark perspective. Hence, if the location of the computer memory would be taken as reference point, a company outsourcing its storage capacity would also move its products, maybe between countries. That is a consequence which seems random and irrelevant. Hence, the geographical location of the storage capacity seems to be a useful reference point in some cases, but more often not.

Another approach discussed in the *conflict of laws* doctrine, is to take the place from where the information in question is used, accessed or disposed over, as reference point. Simply put, the relevant place would be the place where the buttons were pushed. An advantage of the method is that it tends to lead to foreseeable results to a greater extent than the earlier mentioned method, as it is easier to ascertain the location of a physical person than that of a computer memory.¹⁸¹ However, it also leads to results that might appear random or irrelevant. It is, for example, easy to connect to the Internet in order to access or change a certain information with the use of a mobile computer and a cellular phone connection. If a holder of such equipment is travelling, he will be able push the relevant buttons in several countries during a short time.¹⁸² Applied on the location of digital products from a trademark exhaustion perspective, this method appears to have both its advantages and disadvantages. The typical consumer could once again be taken as a departure point in the discussion. According to this method, it would not matter whether he downloads a purchased digital product to his own local computer or to an external computer memory (for example provided by a web-mail service). As long as the dispositions over the product are made from one location, that location would be taken as the reference point. The method seems useful also in some cases when the digital product is disposed over from more than one location. A consumer storing a digital product – for example a digitized book – on an external memory, can access and use the product from various locations. That situation would then be comparable with that of a consumer bringing a tangible book with him on his trips. If he chooses to sell it to a third party at one of these locations, the question of trademark exhaustion would be judged according to local law. The same could be the case regarding the digital product that he “brought” on his trip. However, in other cases, the method appears to be less advantageous. The example above is not applicable to all situations. Suppose for example. Suppose the product or products in question are bought for commercial purposes by a company. It would then appear irrelevant to let every use or disposal over them redefine their legal location, especially if they were disposed over by persons from different countries. With this method, the legal whereabouts of the product would then change between the countries from which the accesses were made. To sum up, the method described in this paragraph seems to be fruitful sometimes, but not always.

¹⁸¹ The method has been proposed for example on the areas of criminal law and intellectual property law, see Bogdan, “Gränsöverskridande förtal i Cyberspace” SvJT 1998 p. 5; Åkerman, Thunman, “Jurisdiktions- och lagvalsproblem på Internet”, p. 440, 448-451.

¹⁸² Bogdan, *ibid* p. 13.

A third method, discussed in the doctrine of *conflict of laws*, is to take the domicile as reference point. In case the discussed party is a company, its place of establishment as reference point. One of the advantages of the method is that it focuses on the person interacting with the information in question, rather than on varying technical solutions. On the other hand, it might appear backwards to focus at the domicile, when the Internet is a medium that provides so many new possibilities of international interaction.¹⁸³ Tangible goods can be easily traded with countries far from the actual location of the goods. In such cases, the domicile or place of establishment of the trader, does not influence the place where the trademark rights to that goods are exhausted. It seems plausible to take the same view regarding digital goods as it is easier to dispose over them from far away. However, the use of the domicile or place of establishment should not be ruled out, as it could serve as reference point under circumstances, when other methods are ruled out.

In some areas of Internet *conflict of laws*, for example tort law, the location where the effects of an act occurs are used as a reference point.¹⁸⁴ However, this method does not appear suitable for the purpose of trademark exhaustion. An act on the Internet, for example the purchase of a digital product, might have effects in several countries, while a digital product needs to be located in country only for the purpose of trademark exhaustion.

Apparently, it seems fruitful to draw *ex analogia* conclusions from the field of *conflict of laws*. However, as the subject of *conflict of laws* on the Internet still appears to be under development, conclusions should be interpreted with care.¹⁸⁵

Conclusion

The problem of the location of a digital product deserves a more thorough examination. However, the conclusion drawn here, is that none of the methods described above can be used in all cases, although a few of the methods could be used in some cases. The most promising alternative is to be to take the place where the relevant buttons where pushed, or to choose the physical location of the computer memory as a reference point.

5.2.6 Obstacles to Digital Parallel Trade?

To state that digital parallel trade in intangible products is not widespread today, is risky, as the Internet is vast, and impossible to survey. The author has not come across such commerce. That is, however, not a reason to state that trade in intangible products does not exist; surely there is evidence that it does. As the Internet has so many users, most things are bound to happen there. However, the parallel trade that

¹⁸³ The domicile is not mentioned as a reference point in Åkerman Thunman, “*Jurisdiktions- och lagvalsproblem på Internet*”. See especially p. 439-441 where the authors discuss which possibilities there are to apply Swedish law on the Internet. On the other hand, Bogdan mentions the domicile as relevant for the purpose of criminal law. See Bogdan *ibid* p. 8. See also Carlén-Wendels “*Nätjuridik - lag och rätt på Internet*”, that mentions the domicile on p. 50-51 on which he from a general viewpoint discusses conflicts of law on the Internet.

¹⁸⁴ Bogdan, *ibid* p. 12-13; see also Åkerman Thunman, “*Jurisdiktions- och lagvalsproblem på Internet*” p. 445-446.

¹⁸⁵ See Carlén-Wendels “*Några kommentarer till jurisdiktions- och lagvalsproblem på Internet*” JT 1997-1998 p. 883.

exists somewhere on the net, has not resounded in the legal literature or in the information and newsletters that has reached the author.¹⁸⁶ This is an observation that may provide the pillars for the following hypothesis: that digital parallel trade does not seem to be an important or significant branch in Internet commerce for the time being. Suppose that this supposition is true. What would be the reasons behind the lack of this kind of commerce? A few obstacles to digital parallel trade in digital products can be observed.

First, most digital products seem to be sold under license agreements including non-distribution clauses. If a buyer of such products nevertheless transfers them to subsequent buyers, he may face legal consequences, especially if such distribution is carried out on a larger scale. As an alternative to the use of legal remedies, the first hand seller of the digital products has the possibility to stop distributing his products to persons violating license agreements.

Second, as digital products are easily copied, a parallel trader in digital products will be vulnerable to accusations of piracy. (Furthermore, a person buying digital products from a parallel trader will have to risk being accused of buying pirate copies.) However, a professional parallel trader in digital products will probably be able to collect enough evidence about his business in order to free himself from such suspicions. Nevertheless, the risk of being sued for making counterfeit copies might be a hindrance to the emergence of trade in exhausted digital products. Regarding products protected by a non-distribution clause, it might, however, be difficult for the parallel trader to put together a record of the transfers of the licensed product. The reason being that the first hand buyer probably will not be in favor of such a record, as it would constitute evidence of his violation of the license agreement.

As it is easy for a rightholder to watermark digital products, he will be able to track down the sources of parallel traded products bearing his brand. In this way, he will be able to spot weaknesses in his distribution lines, and to act upon them. The ECJ case of *Ballantine*, is a case in point. It regarded, among other things, identification codes, but on whiskey bottles. The parallel trader in the *Ballantine* case removed the codes from the bottles, (something that would be more difficult to do to a digital product) in order to hinder *George Ballantine & Son Ltd (Ballantine)*, the company owning the trademark in question, from tracing the source of the parallel traded bottles. The Court found that the codes were used for the purpose of impeding parallel trade within the Union, which is a purpose the Court could not protect. However, the codes had alternative purposes, namely to, among other things, be instruments in the struggle against counterfeit goods. Hence the Court found that it could not allow their removal.¹⁸⁷ Instead, the Court pointed out the treaty's competition rules for the

¹⁸⁶ In addition to the literature elsewhere in this thesis, a few e-mail newsletters regarding legal matters and the Internet should be mentioned: "*Steve White Computer Law, Intellectual Property, Information Technology & Telecommunications Newsletter*", to be found at www.computerlaw.com.au/; "*A Vision Beyond*", to be found at <http://www.cyberlaw.se/swedish/nyhetsbr1.htm>; "*Brussels Bulletin*", to be found at www.dibblupton.co.uk/; "*Fenwick and West Intellectual Property Bulletin*", to be found at www.fenwick.com; "*Media Alert - New Research From Forrester*", to be found at www.forrester.com/; "*Uppsnappat*", to be found at www.uppsnappat.com/. Neither have digital parallel trade been discussed in the e-mail lists of which the author is a member.

¹⁸⁷ The holder of a trademark can in principle oppose the importation of goods bearing his trademark if they have been tampered with in some way. (Article 30 [36] first sentence.) However, if the goods is

checking of artificial trade restrictions through the use of such codes.¹⁸⁸ The Ballantine case illustrates how identification codes, or digital watermarks, can be used to restrict trade. It is still to be shown what protection the competition control can provide on the field of watermarking of digital products.

Fourth, counterfeit copies of digital products today hold a large part of the market. It might be hard for a parallel trader to get market shares. On the other hand, the Internet community has more than once showed that it quickly adopts new fields of applications of the Internet.¹⁸⁹

Finally, as the protection of other intellectual and industrial properties is differently outlined than trademark protection, there might be other obstacles to second-hand trade than trademark law provides for. Copyright protection is probably the most important of them.¹⁹⁰ In any case, the other intellectual and industrial property rights must be examined to give a fuller picture of the legal situation.

6 Conclusion

The principle of trademark exhaustion has been applied for nearly 30 years by the ECJ, with good experiences. The principle of community exhaustion has played an important role in the making of the internal market, as it has been the working principle behind the removal of some of the trade restrictions between the member states.¹⁹¹ During these 30 years, the ECJ has upvalued trademark rights significantly, with the consequence that the ECJ today is letting the territoriality of trademark rights have a greater impact on the trade in the community than it originally had. When the function of a trademark as a guarantee of the commercial origin of the product is endangered by the importation of goods from other member states, the borders are today closed for those goods. The principle of community exhaustion was codified 10 years ago, and it appears to have found a functional form, that can last until – if that is going to happen – the trademark laws of the EU member states merge into one. Towards third countries the Union does not apply the most generous approach, as it does not accept goods marketed outside the common market as exhausted. This has been criticized, but as both the legislating bodies of the Union and the Court have

bearing labels or similar that constitute obstacles to their importation, they may under circumstances be removed or replaced by the parallel importer. (Article 30 [36] second sentence. See also section 4.6.) Accordingly it would have been allowed to remove the codes if they would not have alternative, legitimate purposes. See Ballantine para. 41-42.

¹⁸⁸ Ballantine, para. 43.

¹⁸⁹ Mark Stefik, “*Trusted systems*”

¹⁹⁰ See for example the amended proposal for a European Parliament and Council directive on the harmonisation of certain aspects of copyright and related rights in the Information Society COM (1999) 250 final, recital 19, in which it is explicitly stated that copyright exhaustion does not arise in case of on-line services, and that “every on-line service is in fact an act which will have to be subject to authorization where the copyright or related right so provides”. This statement seems to be in accordance with the Commission's view that on-line deliveries of digital products should not be dealt with as goods. However, the proposal has not yet been adopted, and can thus not be regarded as authoritative.

¹⁹¹ Quitzow, “*Fria varurörelser i den Europeiska gemenskapen. En studie av gränsdragningar mellan gemenskapsangelägenheter och nationella angelägenheter.*” p. 273-274. Lidgaard, “*Regional konsumtion i EU hindrar parallelimport från lågprisländer*”, p. 54-55.

consented on it, it is likely to be maintained for the coming years.¹⁹² However, the area in which community exhaustion is applied will hopefully be enlarged towards Eastern and Central Europe in the coming years, as the Union takes up new members.

In recent years, the Internet has emerged as a new global arena on which commerce is increasing rapidly. It has, however, not yet shown if the exhaustion principle, shaped for traditional trade as it is, is suited for Internet trade. As trade in tangible goods has moved over to the Internet, it appears as no entirely new problems have arisen. However, some old problems have become more accentuated. The Internet is today “inhabited” by millions of people, interacting and communicating with each other, with the consequence that the activity on the Internet is impossible to survey (luckily enough!). If webshops aimed at parallel trade are set up, the rightholder might have a hard time finding them. The prospects of stopping parallel trade at the border, or at the arrival of the imported goods, do not look better. The goods are not easily found if they are shipped as ordinary mail shipments. However, things are surely not as bad as outlined here, as most people want guarantees of delivery, and that their credit card numbers do not fall into the wrong hands. Such guarantees can be given by anyone, but customers will be more likely to believe guarantees given by well-known shops.

If the problems of traditional parallel trade on the Internet seem difficult to cope with, there is a potential for even worse problems regarding digital products. It is today hard to know whether parallel trade in such products will grow strong or not. If that happens, it will show if the EC exhaustion principle is suited to cope with upcoming problems. In this thesis, the exhaustion principle has been applied to some possible situations regarding digital products. The results indicate that the principle could be applied with reasonable results. However, it should be recalled that the applications were made from a theoretical viewpoint, as the author of this thesis has not yet come across actual problems regarding the exhaustion of digital products. Will the exhaustion principle have to be changed? Trade on the Internet is considerably different from traditional trade. The interests of the parties and risks of infringements are different. In tangible trade, the ECJ has focused on the trademark’s function to guarantee the origin of the product in question, something that is none the less important regarding digital products. A customer purchasing counterfeit digital products might for example get his computer infected by viruses. Producers of digital products, additionally, faces an entirely new problem that has not been known in tangible trade, namely the production of huge amounts of counterfeit products, products which are identical to the original product. This might call for changes in the exhaustion principle. Maybe the court will have to be tougher on parallel traders in digital products than to others, to make sure that they do not sell pirate copies. Another difference is that the case law on repackaging and relabelling does not seem to be needed regarding digital products. It is very hard to change the label on a digital product, and it lacks package. A further difference between traditional trade and digital trade is that appears harder to stop digital trade at national borders. Hence, it appears to be considerably harder to maintain EU-wide exhaustion for digital trade than for tangible. It is, for example, very difficult to detect a digital product transfer. However, one of the largest problems regarding the exhaustion of digital products seems to be their geographical location. If a product is stored somewhere on a

¹⁹² Lidgaard, “*Regional konsumtion i EU hindrar parallelimport från lågprisländer*”, 49-53.

worldwide network, it seems to be very difficult to establish where. As the exhaustion principle is based on the territoriality of trademark rights, this might be a large obstacle to the shaping of a practical exhaustion principle applicable on digital trade. In accordance with what has been said here, the principle of trademark exhaustion might have to be applied differently on digital trade than on traditional. However, it should be recalled that it is not a good idea to reshape the exhaustion principle on grounds only of trademark exhaustion. The other kinds of industrial and intellectual property need to be included in the discussion, as the principle is based on the whole specter of rights.

The legislating bodies of the EU have chosen not to address digital parallel trade in digital products. Instead, they regard all digital deliveries as services. It is disputed if that is wise or not. If any cases regarding this kind of trade reaches the ECJ, their outcomes are of great interest. However, if the Court chooses not to acknowledge the trade as parallel trade in the meaning of its case law, but instead lets the parallel trader be sued as a pirate service provider, then that would appear to be in accordance with the current legislation.

But then again, perhaps no such case will ever reach the ECJ. Obstacles to parallel trade in digital products mentioned in this thesis might put an end to it before it even started. Largely, the obstacles seem to rely on the problem of counterfeit products. It simply is very hard for a rightholder to protect against piracy, and some of the instruments that are possible to use impede parallel trade. However, trusted systems might provide for an effective solution. In spring 1999, a few such systems were introduced. If they gain the large market share that they for sure are intended to do, trade in digital products is likely to be reshaped. The commerce will then be more similar to traditional trade, with the exception that subsequent transfers of the products are prohibited. Thus, parallel trade will be made impossible. On the other hand, much of the legal uncertainties haunting digital trade would disappear. However, it is also possible that trusted systems providing for second hand transfers will appear. Such systems could allow transmissions of digital products from one computer to another, after which the product could be automatically erased from the transferring computer. Digital parallel trade would thereby be given a safe legal environment, and the traders would not have to fear the suspicion of piracy any more. Trusted systems allowing for subsequent transfers might be unprofitable to construct for the companies selling the content used in such systems. If they would, they would give up their monopoly, and probably lose some market shares. But then again, others might want to influence the development. Maybe consumer unions might want to act. And maybe the open-source movement. However, this closing chapter is not intended to be speculative. It is not possible to know about the future of the Internet or the trade that takes place there. Only one thing can be known for sure, that the future developments will be of interest for the legal doctrine.

7 Appendix

The Internet, Definition and History¹⁹³

The Internet can be described as a "global matrix of interconnected computer networks using the Internet Protocol (IP) to communicate with each other." In this paper I will use the term "Internet" to encompass all such data networks with their different applications, e.g. the World Wide Web, e-mail etc that run on those networks. Some of these networks may technically not be a part of the Internet, but that is irrelevant for the purpose of this thesis.¹⁹⁴

The computer network that we call the Internet was invented in the late 1960's at universities in the United States. At that time, personal computers were still regarded as science fiction. The network, called ARPANET, was a small network only used by researchers to transfer information and get remote access to computers. As e-mail was invented, it soon became the most popular application. Computer networks were known earlier, but ARPANET brought something new: the packet-switching technology, which still is the working principle of the Internet. The information that is to be transferred between two computers is divided into "packages". The package's route is not determined as it leaves the host computer, but depending on the available connections and the intensity of traffic, each single package is successively routed further to the receiving computer. Once there, the information is put together, and missing packages are reordered. In this way it is possible to overcome disturbances, interruptions and other connection problems. Also, the network is decentralized, which makes it possible for the network to function, even if parts of it are malfunctioning.

The original protocol - the "language" used by the computers to communicate - was a "closed" protocol, meaning that all connected computers must have a standardized internal architecture. However, early on there existed a vision of an Internet where all computer networks in the world could connect into one, independent of their internal architecture. In 1983 this was made a reality as ARPANET choose the "open" protocol TCP/IP as its official protocol. Henceforth, the Internet could grow without hindrance, also beyond the United States. At the end of the 1970's, ARPANET had grown to approximately 150 host computers. In 1984 there were about 1000 host computers, in 1986 10 000, in 1988 100 000 and in 1992 1 000 000.¹⁹⁵

An important event in the history of the Internet was the adoption of the domain name system (DNS) in 1983, which made it possible to identify addresses with text based names rather than numbers. A typical domain name is "http://www.jur.lu.se" (which leads to the Lund University Faculty of Law). The address ends with ".se", which is

¹⁹³The historical and technological remarks are based on Gunnar Gunnarsson, "*Internetboken*", p. 235-238 and Thomas Carlén-Wendels, "*Nätjuridik*", p. 23-29.

¹⁹⁴This is a definition of the Internet used in "*The Emerging Digital Economy*", a US-government report published in April 1998, p. 1. See www.ecommerce.gov/ (17.5.99).

¹⁹⁵ Sweden was connected to the Internet rather early, as the Swedish University Network adopted TCP/IP in 1988.

the top-domain of the address. The top-domain “.se” indicates that it is a Swedish address. In addition to the country-based top-domains, there are the generic top-domains “.com”, “.edu”, “.int” etc, which instead of a country, indicates the kind of body the address is pointing at. However, that indication may be incorrect, as private persons for example can get a “.com” address, which strictly speaking indicates “commercial”. Further, it is often easy to acquire a top-domain in a country where you are not a resident.¹⁹⁶ Between 1989 and 1992, European researchers invented the World Wide Web (WWW). The WWW makes it possible to use hypertext links, or hyperlinks, to direct users to other parts of the Internet by a simple mouse-click on a hyperlink. A WWW-page can include text, graphics, sounds and animations. The Internet now had the potential to be a popular medium and to be used commercially.

The Internet consists of a lot of connected networks. Some of them are publicly owned, and others are privately owned. There is no central administration. Issues that must be jointly solved, as e.g. the distribution of domain names, have until now been addressed by those private bodies with enough authority to get their decisions accepted. However, as the importance of the Internet is increasing, the United Nations has showed an interest to take part in the administration of it.

It is hard to provide statistical figures on the use of the Internet. There are no official statistics, and the estimations differ between those companies and researchers that try to measure the activity. At the best, the estimations are educated guesses, outdated quickly, as the Internet has been doubling in size every year the last few years. However, according to the New York company NUA Ltd.¹⁹⁷, there were 165 million Internet users in May 1999, and according to Network Wizards¹⁹⁸ there were 43 million Internet hosts in January 1999.¹⁹⁹

In 1994, the first shopping mall on Internet arrived,²⁰⁰ and since then, consumer oriented Internet trade has been growing quickly. Though such trade is widespread today, trade between businesses is estimated to be larger. This is likely to be a reflection of commerce in the physical world, where business-to-business commerce also exceeds business-to-consumer commerce.²⁰¹ There are also many services available for the Internet user, including newspapers and magazines, "radio broadcasting" services and other information services. Some are free of use, while others must be paid for. Today there are a large number of Internet applications being used. Besides the WWW and e-mail, there are discussion boards, mailing lists and other mediums for discussion and debate. The entertainment industry are using audio and video applications, that nowadays can be used in "real time", without having to wait for the entire information load to be downloaded. It is further possible to "chat" in real time with other users, using both text and voice messages. Today the most

¹⁹⁶ Thomas Carlén-Wendels, "Några kommentarer till jurisdiktion- och lagvalsproblem på Internet", p. 884-885.

¹⁹⁷ WWW.nua.ie/surveys/how_many_online/index.html (17.5.99).

¹⁹⁸ WWW.nw.com/zone/WWW/report.html (17.5.99).

¹⁹⁹ In Sweden, nearly half of the adult population used the Internet during April 1999. This according to the research institute Sifo, www.sifointeractive.com/ (17.5.99).

²⁰⁰ Robert Zakon, "Hobbe's Internet Timeline", <http://www.isoc.org/zakon/Internet/History/HIT.html> (17.5.99)

²⁰¹ Weje Sandén, "Nätet som marknadsplats - De svenska pionjörerna", Teldok 123, p. 151.

common way to access the Internet is by a telephone connection, but hardware developers are experimenting with other possibilities including cable TV connections, radio links and even ordinary electrical circuits. The WWW and e-mail can today further be accessed on newly developed television sets and mobile phones. The broad variety of applications and ways to connect to the Internet forebodes a melting-together of the different ways through which we today transfer remote information. In near future it will probably be possible to distribute television, phone calls and on-demand-movies over the Internet. However, there are also worries that the Internet will reach its transmission capacity when so much information is put through. Hence, the transmission capacity of the Internet must be increased in order to utilize its many advantages. This especially, as the pace of new innovations on the net is high. It has always been hard to predict the development of the Internet, but if current trends prevail, the use of the net will continue to grow fast.

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