

# Exceptions to Trade Mark Exhaustion: Inalienability Rules for the Protection of Reputational Economic Value

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☞ Brand names; EU law; EU trade marks; Exemptions; Exhaustion of rights; Reputation

## Abstract

*This article analyses the exceptions to the principle of exhaustion of trade mark rights from the perspective of the functions theory and the concept of inalienability rules. Despite its traditional hostility towards the imposition of restrictions to the alienation of chattels, the law often chooses to protect entitlements through inalienability rules with a view to achieving economic efficiency.*

## The doctrine of exhaustion in light of background private law principles

There is no doubt that the doctrine of exhaustion of trade mark rights is of grave economic importance. It allows consumers to enjoy the benefits of free trade on goods already placed on the market with the trade mark proprietor's consent and promotes competition in the collateral markets for specific dealings with those goods, including repair and maintenance services.<sup>1</sup> As a counterbalance, trade mark law recognises some exceptions to trade mark exhaustion in order to protect legitimate interests of trade mark owners.<sup>2</sup> Understandably, the emphasis has been placed on the aspect of the doctrine that prevents the trade mark

proprietor from distorting the downstream commercialisation of goods she has already put into circulation by virtue of her exclusive right. Scholars have meticulously explored the economic dimension of the doctrine<sup>3</sup> and European courts have been vigilant in rejecting interpretations of the law that would undermine the trade mark proprietor's authority to place the goods bearing her mark on the market for the first time or circumvent the principle of regional exhaustion.<sup>4</sup>

On the other hand, the only exception to the exhaustion of the rights conferred by a trade mark that is explicitly mentioned in the text of all European trade mark law instruments issued so far relates to the ageless problem of adulterated goods. Of course, neither art.15(2) of the Trade Marks Directive<sup>5</sup> nor its counterpart in the EUTMR<sup>6</sup> contain an exhaustive list of grounds upon which the trade mark proprietor would be able to assert her rights to oppose the further commercialisation of trade-marked goods. In accordance with the broader policy goals of trade mark law, the European Court of Justice (ECJ) has indeed recognised economically significant exceptions to the exhaustion rule for the purpose of protecting the advertising value encapsulated in a trade mark, especially when it is featured on goods characterised by an aura of luxury and exclusivity.<sup>7</sup> Compared with the policy justifications underpinning the exhaustion of trade mark rights as a legal concept, the exceptions to that doctrine remain somewhat under-theorised.

Several legal principles operate cumulatively to pull strings within the interpretation of the law so that any departures from the rule of trade mark exhaustion remain confined to a narrow field of application. At the European level, the absence of trade barriers within the internal market is an overriding principle of primary EU law that is sturdily anchored in the provisions establishing the free movement of goods and a system of undistorted competition. Similar background principles concerned with the freedom of trade and competition can be found in the private law traditions of national jurisdictions. Trade mark exhaustion has been perceived as operating in a fashion that is analogous to the function of civil law rules on good-faith acquisition, for instance.<sup>8</sup> Within a very few years, the US Supreme Court has explained the exhaustion doctrine as a manifestation of the traditional common law hostility towards the imposition of

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<sup>1</sup> S. Ghosh and I. Calboli, *Exhausting Intellectual Property Rights: A Comparative Law and Policy Analysis* (New York: Syracuse University, 2018), pp.25 and 35 (offering an insightful account of the diverse policies animating the doctrine of exhaustion).

<sup>2</sup> See, generally, L.G. Grigoriadis, *Trade Marks and Free Trade: A Global Analysis* (Cham: Springer International, 2014), pp.331–426; C. Stothers, *Parallel Trade in Europe: Intellectual Property, Competition and Regulatory Law* (Oxford: Oxford University Press, 2007), pp.71–126; F.C. Urlesberger, “Legitimate Reasons’ for the Proprietor of a Trade Mark Registered in the EU to Oppose Further Dealings in the Goods After They Have Been Put on the Market for the First Time” (1999) 36 C.M.L.R. 1195.

<sup>3</sup> For an overview, see K.E. Maskus, “Economic Perspectives on Exhaustion and Parallel Imports” in I. Calboli and E. Lee (eds), *Research Handbook on Intellectual Property Exhaustion and Parallel Imports* (Cheltenham: Edward Elgar, 2016), p.125.

<sup>4</sup> See, generally, I. Calboli, “Reviewing the (Shrinking) Principle of Trademark Exhaustion in the European Union (Ten Years Later)” (2012) 16 Marq. Intell. Prop. L. Rev. 257.

<sup>5</sup> Directive 2015/2436 to approximate the laws of the Member States relating to trade marks [2015] OJ L336/1 (Trade Marks Directive). This Directive has replaced Directive 2008/95 to approximate the laws of the Member States relating to trade marks [2008] OJ L299/25 (TMD 2008), which had in turn codified and replaced Directive 89/104 to approximate the laws of the Member States relating to trade marks [1989] OJ L40/1 (First Trade Marks Directive).

<sup>6</sup> Regulation 2017/1001 on the European Union trade mark [2017] OJ L154/1 (EUTMR).

<sup>7</sup> *Parfums Christian Dior SA v Evora BV* (C-337/95) EU:C:1997:517; [1998] 1 C.M.L.R. 737 at [46]–[47].

<sup>8</sup> R. Ingerl and C. Rohnke, *Markengesetz, Gesetz über den Schutz von Marken und sonstigen Kennzeichen*, 3rd edn (Munich: C.H. Beck, 2010), s.24 Rn.8, pp.1040–1041.

restrictions to the alienation of chattels.<sup>9</sup> Ruling that the patentee may not invoke her exclusive rights to enforce contractually imposed post-sale restrictions with regard to the patented product, the court referred to the “first sale doctrine” as marking “the point where patent rights yield to the common law principle against restraints on alienation”.<sup>10</sup> A few years earlier, when the court ruled that the sale of a copyrighted article in a foreign market triggers the exhaustion of the copyright owner’s rights regardless of whether the product had been manufactured outside the US, it portrayed exhaustion as “a common-law doctrine with an impeccable historic pedigree” reflecting “the common law’s refusal to permit restraints on the alienation of chattels”.<sup>11</sup> Notably, both cases have cited Lord Coke’s reiteration of the common law rule back in the early 17th century to support their propositions.<sup>12</sup>

Appreciating the link between the exhaustion doctrine and private law concepts favouring the unconstrained trade on goods already placed on the market with the consent of the trade mark proprietor induces us into further syllogistic steps. Despite its apparent hostility towards trade restraints, the law quite often employs inalienability rules to promote efficiency considerations or some other policy goal. Hence, the exceptions to trade mark exhaustion may be studied and, at least partially, explained as rules restricting the alienability of trade-marked goods to implement trade mark law policies.

The second part of this article seeks to emphasise the point that the exhaustion rule does not constitute a sort of “natural” trade mark law principle depriving the trade mark proprietor of every possibility to interfere with the downstream commercialisation of the trade-marked good. It is a rule established by the legislator, which occasionally confers upon the proprietor a significant degree of control over the distribution channels for her products. This article examines that aspect of the doctrine by looking at its historical development and application in various trade mark systems.

The third part examines the exceptions to the principle of exhaustion recognised by the European system of trade mark protection, and as formulated in the relevant judgments of the ECJ. The justification for recognising these exceptions offered by the ECJ focuses on the need to secure incentives to create and maintain reputational value and not on the need to avoid an impairment of a trade mark function. On the other hand, it is widely accepted that the authority of the trade mark proprietor to oppose the further commercialisation of a trade-marked good after its first sale can be justified through recourse to the legal concept of the trade mark functions, and, in particular, the advertising function. This article elaborates upon those arguments to illustrate how the quality

function of trade marks, understood broadly enough to mirror the concept of quality perception established by marketing science, could corroborate such justifications of the exceptions to the exhaustion principle despite its accessory nature. Given, however, the controversy about the functions theory and the need to explain the rationale behind the legal recognition of the advertising function especially when it is bound to interfere with the free flow of trade, a more solid justification is necessary.

The fourth part draws upon the observation that both the exhaustion doctrine and its exceptions are intertwined with the broader policy question pertaining to the circumstances under which the legislator or the courts tend to opt for inalienability rules to protect entitlements. This article examines the nature and the function of inalienability rules as instruments for achieving particular efficiencies without excluding other considerations such as distributional goals. It then shows how the exceptions to the exhaustion rule operate as inalienability rules. In that regard, trade mark law does nothing different than other areas of law when they seek to achieve the conservation of some resource. The fifth part summarises and concludes.

## The doctrine of exhaustion—the freedom of trade and its restrictions

The doctrine of exhaustion aims at regulating the extent to which intellectual property (IP) rights may be relied upon to exercise some control over the distribution channels for the products they cover. In its most aggressive form, as envisaged by Josef Kohler<sup>13</sup> and the German jurisprudence in the advent of the 20th century, not only does it exclude the possibility of the IP owner to oppose the further commercialisation of the goods she had put in circulation with her consent, but also renders any contractually imposed sale restrictions ineffective, giving prominence to the absolute freedom of trade.<sup>14</sup> Under the more flexible approaches adopted in the course of time, the doctrine of exhaustion does not affect the validity of terms imposing restrictions on the right of alienating the purchased good, which is assessed by other substantive law rules, and, depending on the competition as well as the trade policy pursued in a given jurisdiction, may allow the trade mark proprietor to retain some authority to interfere with downstream sales and parallel imports by virtue of her exclusive right. Even in the latter case, however, such restrictions would be of exceptional character since maintaining trade freedom is of paramount economic importance.

<sup>9</sup> *Impression Products Inc v Lexmark Intern Inc* 137 S. Ct. 1523, 1531–1532 (2017).

<sup>10</sup> *Impression Products v Lexmark Intern* 137 S. Ct. 1523, 1531 (2017).

<sup>11</sup> *Kirtsaeng v. John Wiley & Sons, Inc.*, 568 U.S. 519, 133 S. Ct. 1351, 1363 (2013).

<sup>12</sup> E. Coke, *Institutes of the Laws of England* (London, 1628), s.360, p.223.

<sup>13</sup> J. Kohler, *Handbuch des deutschen Patentrechts* (Mannheim: J. Bensheimer, 1900), pp.452–459. See also Friedrich-Karl Beier, “Zur Zulässigkeit von Parallelimporten patentierter Erzeugnisse” [1996] G.R.U.R. Int. 1, 3.

<sup>14</sup> C. Heath, “Parallel Imports and International Trade” (1997) 28 I.L.C. 623, 624–626; J. Schovsbo, “The Exhaustion of Rights and Common Principles of European Intellectual Property Law” in A. Ohly (ed.), *Common Principles of European Intellectual Property Law* (Tübingen: Mohr Siebeck, 2012), p.169, pp.171–172.

### The implied licence theory

An illustrative example of a flexible approach can be found in British trade mark law as it stood before the implementation of the First Trade Marks Directive.<sup>15</sup> Exclusive rights in source-identifying signs were enforced for the first time around the middle of the 19th century by the courts of equity in the context of adjudicating disputes involving misrepresentations about the commercial origin of goods.<sup>16</sup> The courts recognised a limited exclusive “right to have a particular trade mark to designate a commodity”, which could only be trespassed upon by the confusing use of an identical or similar mark for identical goods.<sup>17</sup> Dealing with goods associated in trade with the proprietor of an earlier mark could not give rise to infringement, since such junior use does not create any confusion as to the origin of those goods. Trade mark rights were incapable of establishing a distribution monopoly to the benefit of their proprietor because they only protected a source identifier.<sup>18</sup> This principle applied regardless of whether the goods were sold in the domestic or some foreign market for the first time.<sup>19</sup>

Nevertheless, traders whose commercial strategy was based on the ability to offer vertically differentiated versions of the same product to match diverse consumer preferences or to price-discriminate taking advantage of the variations in demand elasticity across different national markets were able to implement their business schemes through contractual terms prohibiting the parallel importation of their products into the UK. The validity of those contractual stipulations was made contingent upon ensuring that subsequent buyers would be made privy to the marketing restrictions, usually through the affixation of a relevant notice to the product. Conversely, if goods had been placed on the market anywhere in the world without any qualification, the trade mark proprietor would be deemed to have granted an implied licence for the goods to be resold freely. Importantly, traders were allowed to partition the various national markets they were operating in by establishing a network of separate legal entities which individually owned the respective national trade mark registrations. If restrictions of parallel imports were in place, the proprietor of the UK

registration would be in a position to prevent the importation of the goods sold under the same mark abroad into the UK.<sup>20</sup>

The implied licence theory, which harks back to *Betts v Wilmott*,<sup>21</sup> remained the guiding principle under the Trade Marks Act 1938 (the 1938 Act). This time, the legislator had to introduce a specific provision depriving the trade mark proprietor of the authority to oppose downstream dealings with goods already circulated with her consent, provided, of course, that she, or a registered user, had applied that mark to those goods or had consented to its use. Since the 1938 Act had rendered the use of an earlier trade mark for the purpose of importing a reference to the trade mark proprietor and/or her goods an infringing act, the new statutory right could be infringed by non-trade-mark uses.<sup>22</sup> Thus, the lack of authority to control the distribution of circulated products by virtue of the exclusive right in the mark affixed to the goods could no longer be justified by the reference to the nature of trade marks as rights to use a mark as an indicator source.<sup>23</sup>

Courts had ruled that sales in foreign markets do not involve an application of the mark in the UK unless it can be ascertained that there had been some intention at the time of the first marketing to eventually sell the goods in the UK as well.<sup>24</sup> Where large conglomerates had been trading through local subsidiaries owning national registrations, UK courts hung back from conclusively ruling that the commercialisation of the trade-marked good abroad by the parent or another subsidiary company amounts to an application of the mark by the trade mark proprietor within the meaning of s.4(3)(a) of the 1938 Act.<sup>25</sup> In effect, parallel imports into the UK could be barred by virtue of national trade mark rights if two conditions were met. First, the registrations in the countries of import and export should be owned by separate legal entities and, second, explicit contractual terms should be in place prohibiting the importation of the trade-marked goods in the UK.<sup>26</sup> The trade mark proprietor cannot be deemed to have consented to the use of the mark in that case. To accommodate the interests of traders who differentiated their products to penetrate foreign markets, British courts modified the traditional common law principle ruling, at a much later stage, that no consent to the use of the mark in the jurisdiction could

<sup>15</sup> Directive 89/104 to approximate the laws of the Member States relating to trade marks [1989] OJ L40/1.

<sup>16</sup> *Millington v Fox* 40 E.R. 956; (1838) 3 My. & C. 338 Ct of Chancery; *Hall v Barrows* 46 E.R. 873; (1863) 4 De G.J. & S. 150 Ct of Chancery.

<sup>17</sup> *Farina v Silverlock* 43 E.R. 1214 at 1216; (1856) 6 De G.M. & G. 214 Ct of Chancery. See, generally, D.M. Kerly, *The Law of Trade-marks, Trade-name, and Merchandise Marks* (London: Sweet & Maxwell, 1894), pp.1-5; for a more recent account and critical appraisal of the law as it then stood, see L. Bently, “From Communication to Thing: Historical Aspects of the Conceptualisation of Trade Marks as Property” in G.B. Dinwoodie and M. Janis (eds), *Trade Mark Law and Theory: A Handbook of Contemporary Research* (Cheltenham: Edward Elgar, 2008), pp.1, 3.

<sup>18</sup> *Farina v Silverlock* (1856) 43 E.R. 1214 at 1217-1218.

<sup>19</sup> *Champagne Heidsieck et Cie Monopole Societe Anonyme v Buxton* [1930] 1 Ch. 330 Ch D.

<sup>20</sup> *Dunlop Rubber Co Ltd v A. A. Booth & Co. Ltd* [1926] 43 R.P.C. 139. See also W.R. Cornish, *Intellectual Property: Patents, Copyright, Trade Mark and Allied Rights*, 4th edn (London: Sweet & Maxwell, 1999), p.41; A.W. White, “Sunglasses: A Benefit to Health?” (1999) 21 E.I.P.R. 176, 178-179 (noting how that state of the law allowed traders to enforce business schemes involving strategies of resale price maintenance or impose sales prohibitions aimed at fortifying sole or exclusive distributorship arrangements).

<sup>21</sup> *Betts v Willmott* (1870-71) L.R. 6 Ch. App. 239 Lord Chancellor.

<sup>22</sup> 1938 Act s.4(2)(b).

<sup>23</sup> T.A. Blanco White and R. Jacob, *Kerly's Law of Trade Marks and Trade Names*, 12th edn (London: Sweet & Maxwell, 1986), p.278.

<sup>24</sup> *Colgate-Palmolive Ltd v Markwell Finance Ltd* [1989] R.P.C. 497 CA (Civ Div) at 522, 533-534.

<sup>25</sup> *Colgate-Palmolive v Markwell* [1989] R.P.C. 497 at 523; *Revlon Inc v Cripps & Lee Ltd* [1980] F.S.R. 85 at 107; (1979) 124 S.J. 184 CA (Civ Div) (Buckley LJ).

<sup>26</sup> *Colgate-Palmolive v Markwell* [1989] R.P.C. 497 at 520-529 (Slade LJ) and 532-536 (Lloyd LJ); *Castrol v Automotive Oil Supplies* [1983] R.P.C. 315 Ch D; see also H. Norman, “Parallel Imports from Non-EEA Member States: The Vision Remains Unclear” (2000) 22 E.I.P.R. 159, 160.

be inferred from the sale of a product abroad which was different in terms of quality to the product offered in the domestic market.<sup>27</sup> For the rest, any unqualified international sale would be tantamount to an implied licence to dispose of the trade-marked goods without import or export restrictions.<sup>28</sup> Importantly, the 1938 Act provided trade mark proprietors with an effective “stick”, allowing them to secure the integrity of their distribution systems. Any failure on behalf of registered users to observe licensing terms and conditions pertaining to the characteristics of the goods, to the mode or place of permitted use, or to any other matter, would give rise to trade mark infringement pursuant to s.28(4)(c) of the 1938 Act.

Common law courts did not have to formulate a doctrine of exhaustion, because dealing with genuine goods did not amount to an infringing act as it did not involve any deception as to the commercial origin of the goods. Exhaustion emerged as a solution to the problem of national trade mark statutes, such as the German trade mark statute of 1894,<sup>29</sup> which explicitly armed rights holders with the exclusive authority of marketing goods under their registered trade marks.<sup>30</sup> Prior to the implementation of the First Trade Marks Directive, some EU Member States, such as Germany,<sup>31</sup> had endorsed an international exhaustion doctrine, whereas others gravitated towards rules that allowed trade mark proprietors to control parallel imports.<sup>32</sup>

### **Regional exhaustion in European trade mark law**

Harmonised European trade mark law adopted a system of regional exhaustion whereby the first sale within the European Economic Area (EEA) exhausts the underlying trade mark rights, with a view to promoting the integration of the internal market and the competitiveness of its industries.<sup>33</sup> It was envisaged, back then, that those goals would have been unattainable if the internal market could at any time be flooded by low-priced goods imported from international markets. Incentives for economic operators within the EU to trade with each other would be reduced, and EU traders would lose many opportunities

to price-discriminate in international trade. Hence, national trade marks rights and EU Trade Marks are exhausted where goods have been placed on the EEA with the proprietor’s consent and traders do not have the option of partitioning the common market by assigning national registrations to local subsidiaries or other economically affiliated entities.<sup>34</sup>

In view of its economic importance, the principle of regional exhaustion has been rigidly applied as a rule that cannot be abrogated by national laws.<sup>35</sup> No consent of the proprietor to the importation of goods into the internal market could be inferred from any unqualified sale which has taken place outside the EEA.<sup>36</sup> Furthermore, the rights of the trade mark proprietor are only exhausted with respect to the specific goods for the marketing of which she granted her consent.<sup>37</sup> Again, such consent may not be inferred from the fact that an economic operator is trading globally.<sup>38</sup> While the exhaustion of IP rights is closely connected with competition law concerns such as the free movement of goods within the internal market, and indeed constitutes a bedrock principle of the system of effective competition that the TFEU seeks to maintain,<sup>39</sup> there has been no serious challenge by any judicial decision so far to the trade mark proprietor’s authority to oppose the importation of goods into the EEA without her consent.

The ECJ has ruled that the assertion of trade mark rights to prevent parallel imports into the EEA does not in itself amount to a concerted practice or an abuse of dominant position even when the profit margin of the goods involved is particularly large and fluctuations between the prices charged in the internal market and those charged in other countries are particularly high.<sup>40</sup> In that case, the court refused to recognise an exception to the principle of regional exhaustion for the purpose of lowering the prices in markets for products such as spare parts, which are characterised by various degrees of lock-in effects, on EU competition law grounds.<sup>41</sup> Many years ago, the court had also ruled that only in exceptional circumstances would the agreement of a European trader with a distributor in a country outside the EEA to refrain from re-importing the contracted goods in the internal

<sup>27</sup> *Colgate-Palmolive v Markwell* [1989] R.P.C. 497 at 526–527 (Slade LJ) and 534–535 (Lloyd LJ). See also D. Alexander, “Colgate-Palmolive v Markwell Finance—The Carving Knife Sharpener” (1989) 11 E.I.P.R. 456, 459; and A. Carboni, “Cases Past the Post on Trade Mark Exhaustion: An English Perspective” (1997) 19 E.I.P.R. 198, 200.

<sup>28</sup> *Revlon v Cripps* [1980] F.S.R. 85 at 107 (Buckley LJ) and 117 (Templeman LJ).

<sup>29</sup> Warenbezeichnungsgesetz 1894 s.12.

<sup>30</sup> *Kölnisch Wasser* RGZ 50, 229.

<sup>31</sup> *Maja* BGH [1964] G.R.U.R. 372; *Cinzano* BGH [1973] G.R.U.R. 468.

<sup>32</sup> See, generally, F.-K. Beier and A. Von Mühlendahl, “Der Grundsatz der internationalen Erschöpfung des Markenrechts in den Mitgliedstaaten der EG und ausgequälten Drittstaaten” (1980) 71 Mitt. D. Patentanwälte 101; R. Klaka, “Markenrechtliche Erschöpfungslehre im neuen Licht” in U. Loewenheim and T. Raiser (eds), *Festschrift für Fritz Traub zum 65. Geburtstag* (Frankfurt am Main: Deutscher Fachverlag, 1994), p.173.

<sup>33</sup> See, generally, I. Calboli, “Trademark Exhaustion in the European Union: Community-Wide or International? The Saga Continues” (2002) 6 Marq. Intellectual Property L. Rev. 47, 80–84.

<sup>34</sup> *Établissements Consten SàRL v Commission of the European Economic Community* (56 and 58/64) EU:C:1966:41; [1966] C.M.L.R. 418; *IHT Internationale Heiztechnik GmbH v Ideal-Standard GmbH* (C-9/93) EU:C:1994:261; [1994] C.M.L.R. 857; *Schweppes SA v Red Paralela SL* (C-291/16) EU:C:2017:990; [2018] E.T.M.R. 13.

<sup>35</sup> *Silhouette Internationale Schmied GmbH & Co KG v Hartlauer Handelsgesellschaft mbH* (C-355/96) EU:C:1998:374; [1998] 2 C.M.L.R. 953 at [31], [37].

<sup>36</sup> *Zino Davidoff SA v A&G Imports Ltd; Levi Strauss & Co v Tesco Stores Ltd; Levi Strauss & Co v Costco Wholesale UK Ltd* (C-414/99 to C-416/99) EU:C:2001:617; [2002] C.M.L.R. 1 at [60].

<sup>37</sup> *Sebago Inc v GB Unic SA* (C-173/98) EU:C:1999:347; [1999] 2 C.M.L.R. 1317 at [21]–[22].

<sup>38</sup> *Sebago v GB Unic* [1999] 2 C.M.L.R. 1317 at [21]–[22].

<sup>39</sup> See, generally, B. Conde Gallego, “The Principle of Exhaustion of Rights and Its Implications for Competition Law” (2003) 34 I.I.C. 473.

<sup>40</sup> *Honda Giken Kogyo Kabushiki Kaisha v Maria Patmanidi AE* (C-535/13) EU:C:2014:2123 at [25].

<sup>41</sup> *Honda Giken Kogyo Kabushiki Kaisha v Maria Patmanidi* (C-535/13) EU:C:2014:2123 at [25].

market have an appreciable effect on the pattern of trade within the EU.<sup>42</sup> So far, no case has arisen where courts or competent authorities have found that a distribution strategy of a trader based on the prohibition of parallel imports into the EEA has adversely affected competition therein. In a similar vein, the UK Supreme Court ruled that the trade mark proprietor's authority to oppose such parallel imports by virtue of her exclusive right was absolute and could not be scaled back with arguments related to the free movement of goods.<sup>43</sup> Euro defences raising competition concerns would normally fail due to the lack of a nexus between the alleged anti-competitive practices and the assertion of trade mark rights.<sup>44</sup>

Furthermore, the ECJ has ruled that the removal of the mark from goods under a customs warehouse procedure which had been circulated in markets outside the EEA with the trade mark proprietor's consent constitutes a use in the course of trade within the meaning of art.15 TMD 2008, so that a third party who has de-branded and modified those goods to comply with various EU regulations could be held liable for trade mark infringement.<sup>45</sup> As the trade mark proprietor had not yet marketed the goods in the EU, the junior use was likely to affect the functions of the mark. It would deprive the trade mark proprietor of her right to place the goods on the internal market for the first time and the opportunity to promote her goods under the mark, as well as reduce her incentives to maintain a reputation capable of generating brand loyalty since European consumers would not be able to recognise those goods as stemming from her.<sup>46</sup> Apart from the teleological interpretation of the requirement for a use in the course of trade in light of the law's purpose of averting impairments to the trade mark functions, the court justified its conclusion by a more general reference to the overriding principle of regional exhaustion which would have been undermined if the defendant were able to escape liability under such circumstances.<sup>47</sup> Last but not least, the European system of trade mark protection confers upon the proprietor the authority to assert her rights against a licensee who contravenes licensing provisions with regard to the scope of the permitted use, including the quality of the goods manufactured or of the services provided under the licence (art.25 Trade Marks Directive). Much like the 1938 Act, harmonised European trade mark law has provided trade mark proprietors with an effective instrument for policing the integrity of their distribution systems.

The extent to which trade mark rights may be relied upon to exercise control over the distribution channels of the trade-marked good depends on the policy decisions of the legislator. As such, the exhaustion doctrine was

originally formulated by German courts to implement a policy decision against the imposition of any restraint on the downstream sales of trade-marked goods arising from the enforcement of trade mark rights. In sharp contrast, as evidenced by the application of the implied licence theory and the right to assert trade mark rights against licensees violating some types of licensing terms provided for in s.28(4)(c) of the 1938 Act, UK law has always recognised a limited but substantial authority of the trade mark proprietor to interfere with the further commercialisation of goods already placed on the market with her consent. Despite the adoption of the term "exhaustion", the European legislator opted for a regime that allows the trade mark proprietor to block undesired parallel imports into the EEA and discipline licensees within her distribution networks to promote policies associated with the proper functioning of the internal market.

### *Common law principles on the alienability of chattels and statutory interpretation in US intellectual property law*

Even though the US Supreme Court placed grave emphasis on the traditional common law principle against the imposition of restrictions to the alienation of chattels, it must not be disregarded that in both cases the outcome was determined, as it should be, through the interpretation and application of statutory law. In *Kirtsaeng*, the key question was whether the reference made in s.109(a) US Copyright Act to the "sale of a particular copy made under this title" could be taken to have introduced a geographical restriction to the doctrine of exhaustion rendering it applicable only to those copies that were originally manufactured in the US or to copies made abroad, but which were sold in the US for the first time.<sup>48</sup> Since the wording of the statute was deemed to be unclear, the court resorted to the general principle of statutory construction, providing that, where there is no clear indication to the contrary, the federal legislator is presumed to have adhered to established common law principles. In fact, the common law rules did not distinguish between foreign and domestic sales.<sup>49</sup> Similarly, the court found in *Lexmark* that there was nothing in the US Patent Act to suggest that the legislator had sought to deviate from the traditional common-law rule.<sup>50</sup> In essence, the US Supreme Court ruled in both cases that the precise scope of the exhaustion doctrine is a matter for the legislator to determine.

<sup>42</sup> *Javico International v Yves Saint Laurent Parfums SA* (C-306/96) EU:C:1998:173; [1998] 5 C.M.L.R. 172 at [28].

<sup>43</sup> *Oracle America Inc v M-Tech Data Ltd* [2012] UKSC 27; [2012] 3 C.M.L.R. 28 at [18]–[20] (Lord Sumption).

<sup>44</sup> *Oracle America v M-Tech Data* [2012] 3 C.M.L.R. 28 at [30]–[32].

<sup>45</sup> *Mitsubishi Shoji Kaisha Ltd v Duma Forklifts NV* (C-129/17) EU:C:2018:594; [2018] E.T.M.R. 37.

<sup>46</sup> *Mitsubishi Shoji Kaisha v Duma Forklifts* [2018] E.T.M.R. 37 at [44]–[46].

<sup>47</sup> *Mitsubishi Shoji Kaisha v Duma Forklifts* [2018] E.T.M.R. 37 at [42], [47].

<sup>48</sup> *Kirtsaeng v John Wiley & Sons Inc* 133 S. Ct 1351 (2013).

<sup>49</sup> *Kirtsaeng* 133 S. Ct 1351, 1363 (2013).

<sup>50</sup> *Lexmark* 137 S. Ct 1523, 1532 (2017).

A thorough review and analysis of the grounds upon which trade mark proprietors in the US are entitled to enjoin the downstream sale of repackaged and reconditioned goods lies beyond the scope of this article.<sup>51</sup> The statutory provisions on border controls and trade mark infringement allow trade mark proprietors to oppose a wide array of undesired parallel imports.<sup>52</sup> In both contexts, the pivotal question is whether a given defendant is trading in goods that are “materially different” from the trade mark proprietor’s genuine goods or domestic goods respectively.<sup>53</sup> Apart from preventing erosion of goodwill that is likely to arise from consumer deception about the quality of trade-marked goods, this statutory regime provides trade mark proprietors with broad leeway for designing and implementing distribution strategies.

All in all, there is nothing like a “natural law” mandate prescribing the total absence of trade mark constraints to the downstream sales of goods already placed on the market with the consent of the trade mark proprietor. It is a matter of statutory interpretation. Prior to its codification in the First Trade Marks Directive, the principle of exhaustion was derived by the ECJ from an interpretation of primary European law that sought to achieve an optimal degree of congruence between the provisions establishing the free movement of goods within the internal market and the competence of the individual Member States to regulate matters related to property situated within their territory.<sup>54</sup> Of course, the freedom of trade has to remain the default principle. Recognising exceptions to the rule in light of efficiency considerations is, however, equally important<sup>55</sup> and, in any case, within the purview of legislative authority.

## The exceptions to the principle of exhaustion in the European trade mark system

### *Exceptions to the doctrine of exhaustion safeguarding against false attributions of quality*

Dealings with trade-marked goods that affect their original condition have always triggered trade mark liability.<sup>56</sup> Common law courts accepted that such instances warranted an exception to the general principle that the exclusive right in a trade mark does not confer upon its

proprietor a distribution monopoly. The trade mark proprietor is exposed to reputational harm when goods that she has placed on the market already have been adulterated, remain in circulation and are still associated with her in trade.

Aside from the straightforward cases of flagrant adulteration,<sup>57</sup> the ECJ has held that the exhaustion defence would also not be available where the original condition of the products might be indirectly affected.<sup>58</sup> Relevant circumstances include, for instance, the repackaging of the trade-marked goods along with a new set of user documentation which conveys incomplete or inaccurate information about the nature, composition, effect, use or storage of the product.<sup>59</sup> Inserting an ingestion or dosage administration device into the packaging of a pharmaceutical product which is not compliant with the regimen of use envisaged by the manufacturer is another example of an indirect adverse effect on a product’s condition through dealings that have taken place after its first sale.<sup>60</sup> Although the court effectively expanded the scope of the exceptions to the exhaustion rule, it also sought to ensure that trade restrictions would only commence where there is a serious risk of reputational harm. Changing the external packaging of the product, fixing self-stick labels in its inner packaging or simply inserting new user instructions therein would not give rise to trade mark infringement in and of itself.<sup>61</sup>

An exception to the exhaustion of trade mark rights through the consented first sale in the EEA is not only justified when there is an imminent risk that low or even bad product quality would be attributed to the trade mark proprietor. Another reason why the trade mark proprietor has a legitimate reason to control downstream sales is to simply protect herself from potential false attributions of quality. It has been accordingly held that the manufacturer of a video game console could successfully assert its UK registered trade mark rights against a parallel importer who had opened the boxes in which the products were packaged to insert the appropriate current adaptors to render the console usable in the UK without identifying their commercial origin.<sup>62</sup> The same issue arose in the *Viking Gas* case.<sup>63</sup> Kosan was selling gas to private and commercial customers in a proprietary composite bottle whose shape had been registered as a EU Trade Mark by a Norwegian company and which it could use under a

<sup>51</sup> J.T. McCarthy, *McCarthy on Trademarks and Unfair Competition*, 4th edn (St Paul, MN: Thomson Reuters, 2017), s.25C.

<sup>52</sup> Tariff Act s.526, 19 U.S.C.A. s.1526; Lanham Act 1946 s.42, 15 U.S.C.A. s.1124; Lanham Act s.32(a), 15 U.S.C.A. s.1114(a); Lanham Act s.43(a)-(b), 15 U.S.C.A. s.1125(a)-(b).

<sup>53</sup> McCarthy, *McCarthy on Trademarks and Unfair Competition* (2017), s.29:46 onwards.

<sup>54</sup> Accordingly, the “specific subject matter” of trade mark rights was held to consist of the exclusive right to use a mark for the purpose of putting products bearing that mark into circulation for the first time. See *Centrafarm BV v Winthrop BV* (C-16/74) EU:C:1974:114; [1974] 2 C.M.L.R. 480 at [8]. See also J.F. Duffy and R.M. Hynes, “Statutory Domain and the Law of Intellectual Property” (2016) 102 Va. Law Rev. 1.

<sup>55</sup> See H.J. Hovenkamp, “Reasonable Patent Exhaustion” (2018) 35 Yale J. Reg. 513.

<sup>56</sup> D.M. Kerly, *The Law of Trade-marks and Trade Name, and Merchandise Marks. With Chapters on Trade Secret and Trade Libel, and a Full Collection of Statutes, Rules, Forms and Precedents*, 5th edn, edited by F.G. Underway and T.W. Morgan (London: Sweet and Maxwell, 1923), pp.463–464 (citing cases).

<sup>57</sup> *Hoffmann-La Roche & Co AG v Centrafarm Vertriebsgesellschaft Pharmazeutischer Erzeugnisse mbH* (C-102/77) EU:C:1978:108; [1978] 3 C.M.L.R. 217 at [14].

<sup>58</sup> *Bristol-Myers Squibb Co v Paranova A/S* (C-427/93) EU:C:1996:282; [1997] 1 C.M.L.R. 1151 at [65].

<sup>59</sup> *Bristol-Myers Squibb v Paranova* [1997] 1 C.M.L.R. 1151 at [65].

<sup>60</sup> *Bristol-Myers Squibb v Paranova* [1997] 1 C.M.L.R. 1151 at [65].

<sup>61</sup> *Bristol-Myers Squibb v Paranova* [1997] 1 C.M.L.R. 1151 at [60]–[63].

<sup>62</sup> *Sony Computer Entertainments Inc v Tesco Stores Ltd* [2000] E.T.M.R. 102 Ch D, 110 (Lloyd J).

<sup>63</sup> *Viking Gas A/S v Kosan Gas A/S (formerly BP Gas A/S)* (C-46/10) EU:C:2011:485; [2011] E.T.M.R. 58.

sole licence for the territory of Denmark. Once the gas was used up, customers would return the bottle they had already bought from Kosan to receive a refilled one after having paid for the price of the gas only. Kosan had affixed its own registered trade marks on the bottles it sold under the licence. Danish consumers had the option of shifting to independent refillers for a better bargain on gas. Those refillers, who had adopted the same business model, affixed their own logos to the bottles but without removing Kosan's marks. In effect, a co-branding scheme emerged from that practice. Kosan sued for trade mark infringement of the shape mark, arguing that it had legitimate reasons to oppose the dealings undertaken by Viking Gas, a refiller, despite the fact that the respective bottles had been placed on the market with its consent. The court noted that the plaintiff could be successful if it were able to establish that consumers have in the meantime been assuming that there is some sort of connection between the parties to the dispute.<sup>64</sup> Apparently, this is largely dependent on the market context shaped by the practices in the relevant business sector, which is, of course, a question of fact for the national court to appreciate.<sup>65</sup>

These exceptions to trade mark exhaustion may be justified through a recourse to the normatively binding concept of the trade mark functions. Dealings having an adverse effect on the original condition of the goods involve an impairment of the origin function, as the consumers normally assume that goods they purchase stem directly from the trade mark proprietor and have not been subjected to any unauthorised interference by a third party which has affected the original condition of the product at some previous marketing stage.<sup>66</sup> At the same time, any adverse effect on the original condition of the goods gives rise to an impairment of the quality function. Traders cannot be expected to constantly maintain the same level of product quality but they have an incentive to market good quality at all times since consumers are capable of punishing the marketing of unsatisfactory quality with the help of trade marks which assist them in avoiding unsuccessful purchases.<sup>67</sup> Evidently, the quality function overlaps with the essential function of origin and is dependent on it.<sup>68</sup> After all, signs that identify goods or services according to their commercial origin constitute

instruments through which traders assume responsibility for the quality they market. In the context of intervening dealings by third parties that adversely affect the original condition of a product already placed on the market with the trade mark proprietor's consent, there is a harmful interference with the quality signal that the trade mark proprietor transmitted when she placed the goods bearing the mark on the market for the first time along with an impairment of a trade mark function. Clearly, in such a case, the functions of investment and advertising are also affected. But recourse to a technical analysis inquiring about a potential impairment of a trade mark function is not necessary for justifying an exception to the rule of exhaustion where the goods have been adulterated by a third party after their first consented sale and before reaching the ultimate consumer.

Although not explicitly suggested, the court had already indicated in *Bristol-Myers* that trade mark functions other than the essential function of origin may justify exceptions to the doctrine of exhaustion. The ECJ noted that, in the case of pharmaceutical products, which is "certainly a sensitive area", "the public is particularly demanding as to the quality and integrity of the product, and the presentation of the product may indeed be capable of inspiring public confidence in that regard".<sup>69</sup> This statement corresponds to user-based definitions of quality offered by business studies, which focus on the consumers' expectations with regard to a specific product.<sup>70</sup> Quality is therefore also assessed by reference to the perceptions or even the subjective preferences of consumers.<sup>71</sup>

Traders are concerned with perceived quality as much as they are concerned with the objective quality of their goods or services.<sup>72</sup> We are all, one way or another, familiar with the notion that it is not enough for something to simply be good; it must also be perceived as such in a relevant market. Perceived quality has many facets, one of which relating to reputation.<sup>73</sup> Where consumers are not able to inspect the quality of a product prior to the purchase, the seller's reputation will be influential to their economic decisions.<sup>74</sup> Apart from remedying problems of information asymmetry, perceived quality is important in itself, as no one can be successful in the marketplace without a good reputation. Cases of "inappropriate

<sup>64</sup> *Viking Gas v Kosan Gas* [2011] E.T.M.R. 58 at [39].

<sup>65</sup> *Viking Gas v Kosan Gas* [2011] E.T.M.R. 58 at [40].

<sup>66</sup> *Bristol-Myers v Paranova* [1997] 1 C.M.L.R. 1151 at [47]–[48].

<sup>67</sup> A. Kamperman Sanders and S.M. Maniatis, "A Consumer Trade Mark: Protection Based on Origin and Quality" (1993) 15 E.I.P.R. 406, 407–408.

<sup>68</sup> D. Keeling, D. Llewelyn and J. Mellor, *Kerly's Law of Trade Marks and Trade Names*, 16th edn (London: Sweet & Maxwell, 2017), para.2-017; *Koninklijke Philips Electronics NV v Remington Consumer Products Ltd* (C-299/99) EU:C:2002:377; [2002] C.M.L.R. 52 at [30]: "the essential function of a trade mark is to guarantee the identity of the origin of the marked product to the consumer or end-user by enabling him, without any possibility of confusion, to distinguish the product or service from others which have another origin, and for the trade mark to be able to fulfil its essential role in the system of undistorted competition which the Treaty seeks to establish, it must offer a guarantee that all the goods or services bearing it have originated under the control of a single undertaking which is responsible for their quality." (Citations omitted.)

<sup>69</sup> *Bristol-Myers v Paranova* [1997] 1 C.M.L.R. 1151 at [76]. See also *Boehringer Ingelheim KG v Swingward Ltd* (C-348/04) EU:C:2007:249; [2007] C.M.L.R. 52 at [43]: "[A] repackaged pharmaceutical product could be presented inappropriately and, therefore, damage the trade mark's reputation in particular where the carton or label, while not being defective, of poor quality or untidy, are such as to affect the trade mark's value by detracting from the image of reliability and quality attaching to such a product and the confidence it is capable of inspiring in the public concerned" (citations omitted).

<sup>70</sup> D.A. Garvin, "What does 'product quality' really mean?" (1984) 26 MIT Sloan. Manag. Rev. 25.

<sup>71</sup> D.A. Aaker, *Managing Brand Equity: Capitalising on the Value of a Brand Name* (New York: The Free Press, 1991), pp.85–86 (defining perceived quality as "an intangible, overall feeling about a brand").

<sup>72</sup> V.A. Zeithaml, "Consumer Perceptions of Price, Quality, and Value: A Means-End Model and Synthesis of Evidence" (1988) 52 J. Mark. 2.

<sup>73</sup> J-B.E.M. Steenkamp, "Conceptual Model of the Quality Perception Process" (1990) 21 J. Bus. Res. 309 (exploring the psychological underpinnings of the concept); D.A. Aaker and R. Jacobson, "The Financial Information Content of Perceived Quality" (1994) 31 J. Mark. Res. 191.

<sup>74</sup> F. Allen, "Reputation and Product Quality" (1984) 15 Rand. J. Econ. 311.

presentation” involve an interference with the reputational signal of the mark that diminishes the product’s perceived quality. This has an adverse effect on the origin function as the trade mark proprietor cannot effectively rely upon the mark to assume responsibility for the quality of the trade-marked good.

Whether dealings with the product that are subsequent to its consented first sale are bound to affect the way its quality will be perceived by the consumers depends therefore on the relevant market and the beholder. In the case of pharmaceuticals sold to hospitals, for instance, it is unlikely that negative associations would result from poor quality or untidy packaging.<sup>75</sup> When, however, such products are sold directly to the ultimate consumers, the presentation of the product would negatively affect their perception of the product’s quality. Consumer distrust of poorly packaged pharmaceuticals would not be dispelled by the fact that these products are subject to prescription.<sup>76</sup> The legitimate reason allowing the trade mark proprietor to oppose the further commercialisation of her products was identified by the court to lie in the need for protecting the mark’s reputation which could be damaged by the marketing of those goods in packaging that is defective, poor quality or untidy. Elaborating upon that rationale, the ECJ has clarified in the meantime that the trade mark proprietor would be able to prevail in all instances of inappropriate presentation of the product which are capable of damaging the reputation of the mark.<sup>77</sup> The instances related to poor-quality packaging referred to in *Bristol-Myers* were deemed to be examples of inappropriate presentation depriving defendants of the argument that plaintiff’s rights have been exhausted. Moreover, the same principles are applicable to products other than pharmaceuticals. Trade mark rights may be asserted to prevent the parallel importation of whiskey, for example, where the product has been repackaged or relabelled in a way that is likely to damage its image of luxury and thereby harm the reputation of the mark.<sup>78</sup> Obliterating or removing batch codes and other similar indicia may also give rise to reputational harm.<sup>79</sup>

As already indicated, though, the recognition of an exception to the rule of exhaustion in cases of inappropriate presentation could also be explained as an impairment to the mark’s quality function, which is understood more broadly in conformity with marketing concepts of product quality drawing on consumer

expectations. We observe, however, that the justification for recognising an exception to trade mark exhaustion due to “inappropriate presentation” as put forward by the ECJ in its relevant judgments leans more toward an argument related to the conservation of the reputation attached to a trade mark as an intangible business value rather than to an impairment of a trade mark function.<sup>80</sup>

### *Exceptions to the doctrine of exhaustion promoting the conservation of brand image*

In *Dior v Evora*, the ECJ was called upon to rule whether the trade mark proprietor may oppose the further commercialisation and promotion of goods characterised by a certain allure, prestigious image and aura of luxury surrounding them, where the circumstances under which the sale as well as the advertising of those goods takes place are bound to damage the reputation they have acquired.<sup>81</sup> Albeit with some caveats, the court answered in the affirmative. Once the exclusionary effect of the right is likely to expand for reasons that are independent from the need to safeguard the origin function, it becomes necessary to consider how to determine the optimal scope of protection. Realising the need to avoid sweeping arguments requesting protection of reputational interests that would unduly restrict the free flow of trade, the court stressed that plaintiffs would only succeed in their trade mark infringement suits if they manage to establish that the junior use has caused, or is likely to cause, serious damage to the mark’s reputation.<sup>82</sup> In fact, the ECJ has adopted a rather careful and balanced approach.<sup>83</sup> At any rate, the trade mark proprietor would indeed be entitled to enjoin resellers from using an earlier mark to advertise the lawful resale of the trade-marked goods even though the respective advertising methods are customary in the field of the reseller’s economic activity provided that the junior use seriously damages the reputation of that mark.<sup>84</sup>

Apparently, the decision constitutes a manifestation of the legal protection awarded to the advertising function of trade marks.<sup>85</sup> One can make that argument since the preliminary question itself, which was repeated in the part of the judgment where the court reiterates its findings, is formulated as inquiring upon the extent to which the advertising function is protected. However, the analysis of the court elaborates upon the justification put forward in *Bristol-Myers*, namely that further commercialisation could be enjoined to protect the reputation of the mark,

<sup>75</sup> *Bristol-Myers v Paranova* [1997] 1 C.M.L.R. 1151 at [77].

<sup>76</sup> *Bristol-Myers v Paranova* [1997] 1 C.M.L.R. 1151 at [77].

<sup>77</sup> *Boehringer Ingelheim* [2007] C.M.L.R. 52 at [40]–[47].

<sup>78</sup> *Loendersloot (t/a F Loendersloot Internationale Expeditie) v George Ballantine & Son Ltd* (C-349/95) EU:C:1997:530; [1998] 1 C.M.L.R. 1015 at [33].

<sup>79</sup> Opinion of Advocate General Stix-Hackl in *Zino Davidoff v A&G Imports; Levi Strauss v Tesco Stores; Levi Strauss v Costco Wholesale* [2002] C.M.L.R. 1 at [121].

<sup>80</sup> German courts have been deciding such cases by applying the functions theory considering interferences with the original condition of the goods as tantamount to an impairment of the quality function. See *Gefürbte Jeans*, Case I ZR 210/93 [1996] G.R.U.R. 271 German Federal Supreme Court.

<sup>81</sup> *Dior v Evora* [1998] 1 C.M.L.R. 737 at [42], [43], [48], [59].

<sup>82</sup> *Dior v Evora* [1998] 1 C.M.L.R. 737 at [42], [43], [48] and [59]. The same point was made in *Loendersloot v Ballantine* [1998] 1 C.M.L.R. 1015 at [33], where the court noted that the reputational interests of the trade mark proprietor must be taken into account in the context of an overall assessment. See also Opinion of Advocate General Stix-Hackl in *Zino Davidoff v A&G Imports; Levi Strauss v Tesco Stores; Levi Strauss v Costco Wholesale* [2002] C.M.L.R. 1 at [121] (requiring a “sufficiently serious” harm). For a more recent application of those principles, see *L’Oréal SA v eBay International AG* (C-324/09) EU:C:2011:474; [2011] E.T.M.R. 52 at [83].

<sup>83</sup> I.S. Fhima, “The Court of Justice’s Protection of the Advertising Function of Trade Marks: An (Almost) Sceptical Analysis” (2011) 6 J.I.P.L.P. 325 (noting the ECJ’s reluctance to adhere to an overbroad and unqualified protection of the advertising function).

<sup>84</sup> *Dior v Evora* [1998] 1 C.M.L.R. 737 at [48].

<sup>85</sup> A. von Mühlendahl, D. Botis, S.M. Maniatis, and I. Wiseman, *Trade Mark Law in Europe*, 3rd edn (Oxford: Oxford University Press, 2016), pp.679–685 (explaining the ramifications of the decision for the protection of the advertising function).

which emerges as the dominant rationale for excluding trade mark exhaustion.<sup>86</sup> This approach could be juxtaposed with the analysis of the ECJ in *Arsenal*, where the court sought to clarify the scope of the double identity rule by explicitly basing its reasoning on the concept of the trade mark functions.<sup>87</sup> This may be explained by considering that reputational damage has always been, from the early times of trade mark protection,<sup>88</sup> the most obvious reason for allowing the trade mark proprietor to interfere with the resale of genuine goods. The line of reasoning of the court elaborates deductively from that notion without it being necessary to engage into the interest balancing exercise associated with the application of the functions theory in order to reach a decision on the proper scope of trade mark protection.

One could in fact make an argument based on the quality function of trade marks to justify the outcome in *Dior v Evora* setting a user-based definition of quality as the starting point of the analysis. There is no statement of the court supporting this proposition. In essence, Dior raised exactly this point by arguing that the expression “condition of the goods” should be broadly understood to encompass “the allure, prestigious image and aura of luxury surrounding the goods, resulting from the manner in which the trade mark owner has chosen to present and advertise the goods using his trade mark rights”.<sup>89</sup> Perceived quality may also refer to brand image.<sup>90</sup> Whether a product meets consumer expectations or not often depends on its capacity to satisfy demand for goods differentiated by brand image.<sup>91</sup> Conversely, even the owners of the most successful brands cannot practically afford neglecting other quality aspects of their products as this would be unlikely to go unnoticed by the consumers.<sup>92</sup> Thus, by conferring upon the goods such “intangible quality”, trade mark proprietors are able to transmit a robust signal of quality assurance at the same time.<sup>93</sup>

Seemingly, the ECJ has endorsed this broader quality function in the *Copad* case.<sup>94</sup> This time Dior went after a licensee who contravened a term imposing an obligation to refrain from selling the contracted goods to discount outlets for the purpose of maintaining the repute and prestige of its female undergarment line of products. The court was asked to rule on whether Dior could invoke its

rights against the licensee pursuant to the rule prescribed in art.8(2) First Trade Marks Directive. According to that provision, the trade mark proprietor may do so if the licensee contravenes

“any provision in his licensing contract with regard to its duration, the form covered by the registration in which the trade mark may be used, the scope of the goods or services for which the licence is granted, the territory in which the trade mark may be affixed, or the quality of the goods manufactured or of the services provided by the licensee”.

Agreeing with the analysis of Advocate General Kokott, the court ruled that the licensee should be deemed to have contravened a term pertaining to the quality of the goods if her actions result in damage to “the allure and prestigious image which bestows on them an aura of luxury”.<sup>95</sup>

The court also ruled that that any sales commenced in violation of the licensing agreement cannot be regarded as having been consented to by the trade mark proprietor.<sup>96</sup> As a result thereof, such sales do not trigger the exhaustion of the respective trade mark rights. In any event, as the court noted, the trade mark proprietor would have legitimate reasons to oppose the further commercialisation on the grounds of such resales damaging the reputation of the mark.<sup>97</sup> Interestingly, the decision does not make any reference to the advertising or investment function of trade marks. Nonetheless, the ruling of the court can be justified by reference to the protectability of those trade mark functions.

Getting back to the *Viking Gas* case, it is important to note that the ECJ essentially ruled that the trade mark proprietor would have the authority to interfere with competition in the secondary market for gas by enjoining refillers by virtue of her exclusive right provided that a legitimate reason for opposing such dealings within the meaning of art.7(2) First Trade Marks Directive had existed.<sup>98</sup> It should be taken into account that, in such a case, the trade mark proprietor is particularly vulnerable to false attributions of quality since the trade-marked bottle has a long life cycle and third parties would repeatedly engage in dealings with the trade-marked good.

<sup>86</sup> *Dior v Evora* [1998] 1 C.M.L.R. 737 at [42]–[43].

<sup>87</sup> *Arsenal Football Club Plc v Reed* (C-206/01) EU:C:2002:651; [2003] 1 C.M.L.R. 12 at [42].

<sup>88</sup> See, for instance, D.M. Kerly, *The Law of Trade-marks and Trade Name, and Merchandise Marks. With Chapters on Trade Secret and Trade Libel, and a Full Collection of Statutes, Rules, Forms and Precedents* (London: Sweet and Maxwell, 1894), p.310.

<sup>89</sup> *Dior v Evora* [1998] 1 C.M.L.R. 737 at [10].

<sup>90</sup> See, generally, Aaker, *Managing Brand Equity* (1991), p.99.

<sup>91</sup> Although persuasive advertising is considered by many a form of wasteful competition and a means of insulation against competition based on quality; see, for instance, R.S. Brown Jr, “Advertising and the Public Interest: Legal Protection of Trade Symbols” (1948) 57 Yale L.J. 1165, at the same time it must not be disregarded that consumers tend to purchase brand image as a good that is complementary to the objective attributes of some basic product G.S. Becker and K.M. Murphy, “A Simple Theory of Advertising as Good or Bad” (1993) 108 Q.J. Econ. 941, 945–952.

<sup>92</sup> D.A. Aaker, *Building Strong Brands* (London: Simon & Schuster Ltd, 2010), pp.19–20.

<sup>93</sup> On all those aspects of the quality function of trade marks, see A. Griffiths, “Quality in European Trade Mark Law” (2013) 11 Nw. J. Tech. & Intell. Prop. 621. Quality assurances often fail miserably in living up to consumer expectations. In the case of luxury goods, the promise of superior quality is greater, which in turn raises the stakes for the trade mark proprietor. For a critical analysis, see I. Calboli, “The Story of Luxury Products and the (Broken) Promise of Superior Quality in a World of Prestige for the Masses” in H. Sun, B. Beebe and M. Sunder (eds), *The Luxury Economy and Intellectual Property: Critical Reflections* (New York: 2015), p.31.

<sup>94</sup> *Copad SA v Christian Dior Couture SA* (C-59/08) EU:C:2009:260; [2009] E.T.M.R. 40.

<sup>95</sup> *Copad v Dior* [2009] E.T.M.R. 40 at [37].

<sup>96</sup> *Copad v Dior* [2009] E.T.M.R. 40 at [51].

<sup>97</sup> *Copad v Dior* [2009] E.T.M.R. 40 at [59].

<sup>98</sup> *Viking Gas* [2011] E.T.M.R. 58 at [42].

The extent to which the principle formulated by the ECJ in *Copad* is also applicable to dealings with products that do not fall under the category of luxury or exclusive goods is not clear.<sup>99</sup> It seems, though, that the proper understanding of the ECJ's ruling is that the principle would be applicable to the sales of goods other than luxury goods. This can be inferred from the court's reference to the non-permitted use as one that damages the reputation of the earlier mark by citing *Dior v Evora*.<sup>100</sup> Notably, the "availability in purposefully restricted and controlled distribution" is a sine qua non element of the luxury concept.<sup>101</sup> This is how the intangible value can be conserved. Beyond that, the ability of the trade mark proprietor to exercise some control over downstream distribution channels protects her against potential abuses by powerful distributors.<sup>102</sup>

The authority of the trade mark proprietor to oppose the further commercialisation of goods placed on the market with her consent in cases of inappropriate presentation may in some circumstances compensate for the absence of a (selective) distribution network, which may not be available because in a given case the requirements for protection mandated by competition law would not be met or the set-up of such a network does not make any business sense in light of high (transaction) costs outweighing any potential benefits.

In fact, the law provides the trade mark proprietor with rights that are effective in enjoining junior uses of her marks where the trade-marked good is presented inappropriately, that is, in a way which not only reduces consumer confidence as to the objective qualities of the goods but also threatens to cause a serious damage to the image they have acquired in the marketplace. This aspect of trade mark protection is particularly relevant to online retail and the operation of e-commerce platforms.<sup>103</sup>

## The exceptions to the principle of exhaustion as inalienability rules

### *The economic case for inalienability rules*

In principle, restrictions to alienation are undesirable because they undermine the efficiency of the market mechanism which operates to ensure that assets will end up being owned by those who value them most through voluntary transactions. The ultimate goal is to put those assets to their best use. Nevertheless, efficiency considerations may in some specific instances militate in favour of imposing inalienability rules. The term

"inalienability" is understood broadly to cover not only naked sale prohibitions but any other legal condition imposed by the legislator on the alienation of an asset.

Calabresi and Melamed have elaborated on this point in their famous work on the protection of entitlements, which explored the various arguments driving the policy choices between property, liability and inalienability rules.<sup>104</sup> They argue that inalienability rules can be relied upon to resolve problems created by negative externalities that cannot be remedied through private bargaining.<sup>105</sup> A housing rule prohibiting the sale of land to a polluter, for instance, would protect all owners in the area, given that high transaction and freeloader costs practically exclude the option of other residents compensating the seller to avoid the external cost.

Inalienability rules would either constitute an appropriate substitute for or complement tort remedies in controlling harm potentially arising from the use of dangerous instrumentalities where injunctions would be difficult to obtain and enforce owing to problems in identifying the wrongdoer who might in any case not be able to pay damages.<sup>106</sup> Gun control constitutes an illustrative example.<sup>107</sup> The scope of the restriction of alienability would depend on the magnitude of the risk of potential abuse. A blanket prohibition of selling machine guns to the public would make sense. In the case of rifles, on the other hand, a partial restriction to alienability, which permits the sale only to a group of people or excludes it within a specific territory, could work in tandem with other remedies and criminal law rules.

Another economic justification for inalienability rules can be found in preventing the overexploitation by individual holders of access rights to a limited-access common pool such as the water rights of those owning property within a block comprising more pieces of adjacent riparian land.<sup>108</sup> Under the traditional common law principles, the sale of water rights was tied to the sale of the corresponding riparian land. In this way, the law avoided a situation whereby the more intensive use by the buyer of the water rights would shrink the water rights of everyone else, while allowing someone who was able to put the seller's property to a more efficient use to do so by acquiring the respective bundle of rights.

Further justifications for restricting alienability in the broad sense, which are driven by efficiency considerations, include the conservation of subject-matter such as wildlife species facing the threat of extinction,

<sup>99</sup> L. Curtis and R. Tilbury, "The aura of luxury" (2010) 5 J.I.P.L.P. 595, 599.

<sup>100</sup> R. Davis, T. St Quintin, and G. Tritton, *Tritton on Intellectual Property in Europe*, 5th edn (London: Sweet & Maxwell, 2018), p.478.

<sup>101</sup> J.-N. Kapferer and V. Bastien, *The Luxury Strategy: Break the Rules of Marketing to Build Luxury Brands* 2nd edn (London: Kogan Page, 2012), pp.47–48, 233 onwards (referring to distribution as "luxury's weak link" and discussing the online retail dimension).

<sup>102</sup> J.L. Nueno and J.A. Quelch, "The Mass Marketing of Luxury" (1998) 41 Bus. Horiz. 61, 66–68 (discussing how manufacturer brands "recovered distribution" over time). *Dior v Evora* and *Copad v Dior* should be read in that market context.

<sup>103</sup> L.A.S. Pascual, "The Peculiar Citadel Function of the Well-Known Trademark in Contracts with Vertical Restrictions: Competitive Strategy, Trademarks and Selective Distribution in Physical and Virtual Networks" (2015) 105 Trademark Rep. 983; I. Kunda and V. Butorac Malnar, "Internet Distribution of Luxury Products: Is There a Deluxe Version of EU Competition Law?" (2018) 39 Zb. Prav. fak. Sveuc. u Rij. 1751.

<sup>104</sup> G. Calabresi and A.D. Melamed, "Property Rules, Liability Rules and Inalienability: One View of the Cathedral" (1972) 85 Harv. L. Rev. 1089.

<sup>105</sup> Calabresi and Melamed, "Property Rules, Liability Rules and Inalienability: One View of the Cathedral" (1972) 85 Harv. L. Rev. 1089, 1111.

<sup>106</sup> R.A. Epstein, "Why Restrain Alienation?" (1985) 85 *Columbia Law Review* 970, 973–974.

<sup>107</sup> Epstein, "Why Restrain Alienation?" (1985) 85 *Columbia Law Review* 970, 974–976.

<sup>108</sup> Epstein, "Why Restrain Alienation?" (1985) 85 *Columbia Law Review* 970, 978–982.

the regulation of close substitutes and the assurance of high-quality output.<sup>109</sup> Alienability restrictions may facilitate the enforcement of a hunting prohibition, for instance. By prohibiting the sale of a close substitute, state authorities may achieve an optimal enforcement of a prohibition against transaction over a specific good, where the distinction between the permitted and the prohibited good is not easy to draw, to mention another example.

Most importantly for our discussion, inalienability rules may offer solutions to problems associated with resource tragedies under some circumstances.<sup>110</sup> One way of avoiding the over-harvesting of a common, for instance, would be to decrease demand on the market for the extracted product by introducing a rule permitting only its immediate consumption while prohibiting its use as an input for the production of long-lasting canned food.<sup>111</sup> The acquisition of property in a fancy neighbourhood may be conditioned upon obligations to engage or refrain from engaging in specific uses of the property to maintain a certain living experience desired by all residents, which constitutes a public good shared in a non-rivalrous and non-excluding fashion among a specific group of people. Such use restrictions render transactions more cumbersome to avoid situations where individuals would not have adequate incentives to maintain and enhance local public goods.<sup>112</sup> Alienation restrictions may also serve the purpose of excluding inefficient draws from a common or deny access to inappropriate harvesters.<sup>113</sup>

One way of looking at the intangible value of the reputation attached to a trade mark would be to perceive it as a pasture from which downstream dealers are allowed to extract value. The flair of exclusivity a trade-marked good may carry is capable of contributing to the maintenance or enhancement of the reputation of its downstream seller. A repairwoman lawfully using the mark of a famous automobile manufacturer to indicate the nature of the services she offers does indeed take a free ride on the positive associations the car brand has come to connote. The very fact that the repairwoman is allowed to communicate to the consumers information about her ability to deal effectively with expensive automobiles facilitates her efforts to build up a good reputation. As the ECJ noted in *BMW v Deenik*, such collateral free-riding is lawful and does not deprive the junior user of the possibility to successfully raise a defence to a claim of trade mark infringement provided, of course, that the respective use is in accordance with

honest business practices in industrial and commercial matters.<sup>114</sup> The exceptions to the rule of trade mark exhaustion serve the purpose of excluding uses that are harmful to the reputation attached to a trade mark. They may exclude inefficient harvesters, such as discounters where appropriate, other downstream sellers who have adulterated the trade-marked goods or have advertised them in a context that is likely to inflict injury to the mark's reputation, as well as providers of repair and maintenance services who promote their own business through advertisements that are detrimental to the marketing power of an earlier mark.<sup>115</sup>

### *Pursuing economic efficiency through exceptions to the principle of exhaustion*

The exceptions to the exhaustion principle operate as inalienability rules in a twofold manner. First, they make the acquisition of the product from the original manufacturer more difficult as they impose conditions on the use of the acquired property. The buyer knows in advance that she will not be able to advertise and/or resell the product under circumstances that are likely to harm the reputation of the mark. Nor will the buyer be able to resell the product if its original condition is affected. Second, they impose the same restrictions to all resales of trade-marked goods that have already been placed on the market with the trade mark proprietor's consent.

We must, however, not lose sight of their proprietary nature.<sup>116</sup> After all, they constitute legitimate reasons on the grounds of which the trade mark proprietor may oppose some downstream sales of her products. Defined broadly, property encompasses every right to control the use of an asset.<sup>117</sup> In that regard, the creation of property rights is animated by a concern to avoid a "tragedy of the commons", a situation where a valuable resource, such as a rich fishing lake, would be depleted, or become very scarce, owing to over-exploitation by economic operators who lack the incentive to invest in the longevity of that resource as they cannot exclude others from its use.<sup>118</sup> Their welfare-maximising strategy would be therefore to extract as much value as possible from the resource as long as there is still time available for doing so. One of the options available to preserve resources that are scarce, non-excludable and rivalrous in consumption is to make them subject to property rights.<sup>119</sup> The notion of the "tragedy of the commons" has been criticised for not considering the inefficiencies potentially arising from the underuse of a resource that has been subjected to property

<sup>109</sup> S. Rose-Ackerman, "Inalienability and the Theory of Property Rights" (1985) 85 Colum. L. Rev. 932, 942–949.

<sup>110</sup> L.A. Fennell, "Adjusting Alienability" (2009) 122 Harv. L. Rev. 1403, 1427 onwards.

<sup>111</sup> Fennell, "Adjusting Alienability" (2009) 122 Harv. L. Rev. 1403, 1430–1432.

<sup>112</sup> Fennell, "Adjusting Alienability" (2009) 122 Harv. L. Rev. 1403, 1434–1438.

<sup>113</sup> Fennell, "Adjusting Alienability" (2009) 122 Harv. L. Rev. 1403, 1432–1433.

<sup>114</sup> *Bayerische Motorenwerke AG v Deenik* (C-63/97) EU:C:1999:82; (1999) 1 C.M.L.R. 1099 at [54]; *Portakabin Ltd v Primakabin BV* (C-558/08) EU:C:2010:416; [2010] E.T.M.R. 52 at [89].

<sup>115</sup> *Dior v Evora* [1998] 1 C.M.L.R. 737 at [48]; *Portakabin v Primakabin* [2010] E.T.M.R. 52 at [84]–[91].

<sup>116</sup> S.M. Maniatis, "Trade Mark Rights—A Justification Based on Property" (2002) 2 I.P.Q. 123 (noting how cases like *Dior v Evora* manifest the nature of trade mark rights as property rights safeguarding the integrity of reputation).

<sup>117</sup> R.P. Merges, *Justifying Intellectual Property* (Cambridge, MA: Harvard University Press, 2011), pp.4–5.

<sup>118</sup> G. Hardin, "The Tragedy of the Commons" (1968) 162 *Science* 1243.

<sup>119</sup> H. Demsetz, "Toward a Theory of Property Rights" (1967) 57 A.E.R. 347.

rights<sup>120</sup> and the fact that efficient resource management may be achieved through proprietary solutions other than the grant of an all-encompassing property right to one single party such as those involving group access often combined with some sort of regulation of individual use.<sup>121</sup> The key insight remains, at any rate, that the conservation of a resource often depends on it being subject to some form of property right.

Non-confusion-based theories of trade mark liability may be explained, at least partially, from that perspective. To the extent that dilution protection protects the uniqueness of a brand or prevents third parties from introducing negative information to the message codified in a commercial symbol, these theories of protection serve the purpose of preserving the advertising value attached to a trade mark as they allow the trade mark proprietor to control harmful uses.<sup>122</sup> Similarly, the protection of marks with a reputation against junior uses that without due cause take an unfair advantage of the repute or the distinctiveness of an earlier trade mark allows the trade mark proprietor to retain control over brand extensions and enjoin uses that may diminish the value of the reputation attached to their mark.<sup>123</sup>

Reputation is an economic value that can be depleted if exploited by multiple parties not sharing the same economic interests. This observation can explain, at least partly, the recognition of publicity rights in some jurisdictions.<sup>124</sup> A similar rationale underlies the tort of passing off even though the legal system in the UK does not provide for publicity rights. In the *Irvine* case,<sup>125</sup> the tort of passing off was, once again, extended to protect reputational interests. It was held that promotional goodwill, that is, reputation having economic value for which a market already exists, constitutes subject matter eligible for protection, which can be protected against misrepresentations as to endorsement.<sup>126</sup> Furthermore, in

the *Irvine* case it was held that loss of “goodwill exclusivity” constitutes an actionable head of damage under the tort of passing off.<sup>127</sup> Eddie Irvine, the Formula One driver, was deemed to have a legitimate interest in determining the context in which the commercial exploitation of his name takes place so that he ensures that its economic value will not be depleted through uncontrolled inefficient uses. Notably, the damage requirement is, according to the view expressed by Jacob LJ in the *L’Oréal v Bellure* case, the one that is actually instrumental in setting the limits of the tort.<sup>128</sup> It becomes apparent that the expansion of the protection granted to the plaintiff’s proprietary interest in the *Irvine v Talksport* case was motivated by a concern to protect a valuable intangible from depletion. The same rationale underpins the protection afforded to product goodwill under extended passing off.<sup>129</sup>

Trade mark law deploys inalienability rules in other contexts as well. Some jurisdictions, such as the US, have imposed important limitations to trade mark transactions, which have been thought of as a means to protect consumers from confusion and secure incentives for maintaining good quality. Trade marks cannot be assigned in gross, and failure to exercise quality control over the goods or services of a licensee may lead to the invalidation of the mark. The respective provisions of the Lanham Act 1946 feature the efficiency function of inalienability rules.<sup>130</sup> UK law has adopted a similar approach with regard to unregistered commercial symbols.<sup>131</sup> Harmonised European trade mark law is characterised by a very liberal stance towards trade mark transactions. Naked assignments and licences are allowed. The absolute ground for refusal of registration and invalidity as well as the ground for revocation pertaining to misleading marks may indeed, however, play the role of an inalienability rule. Let’s take an example inspired

<sup>120</sup> M.A. Heller, “The Tragedy of the Anticommons: Property in the Transition from Marx to Markets” (1998) 111 Harv. L. Rev. 621.

<sup>121</sup> R.C. Ellickson, “Property in Land” (1993) 102 Yale L.J. 1315.

<sup>122</sup> R.C. Denicola, “Institutional Publicity Rights: An Analysis of the Merchandising of Famous Trade Symbols” (1984) 62 N.C. L. Rev. 603, 637–638; G.N. Magliocca, “One and Inseparable: Dilution and Infringement in Trademark Law” (2001) 85 Minn. L. Rev. 949, 976–977; W. Landes and R. Posner, *The Economic Structure of Intellectual Property Law* (Cambridge, MA: Harvard University Press, 2003), pp.227–228. Some academic commentators have challenged the notion that concerns associated with the tragedy of the commons arise in the context of IP rights and, in particular, trade marks because intangible property may not be depleted through overuse as easily as physical property since it constitutes a good that is non-excludable and non-rivalrous in consumption. See M.A. Lemley, “Property, Intellectual Property, and Free Riding” (2005) 83 Tex. L. Rev. 1031, 1050–1051. Others have argued that empirical evidence does not make a strong case for dilutive harm actually occurring. See R. Tushnet, “Gone in Sixty Milliseconds: Trademark Law and Cognitive Science” (2008) 86 Tex. L. Rev. 507. Their criticism illustrates why dilution laws are applicable only to limited situations: McCarthy, *McCarthy on Trademarks and Unfair Competition* (2017), s.24:67; B. Beebe, R. Germano, C.J. Springman and J.H. Steckel, “Testing for Trademark Dilution in Court and the Lab” (2019) 86 U. Chi. L. Rev. 611, 656–660 (offering an analytical framework for establishing likelihood of dilution by blurring); see *Intel Corp Inc v CPM United Kingdom Ltd* (C-252/07) EU:C:2008:655; [2009] E.T.M.R. 13; *Environmental Manufacturing LLP v Office for Harmonisation in the Internal Market (Trade Marks and Designs) (OHIM)* (C-383/12 P) EU:C:2013:741 (imposing stringent evidentiary requirements). For a critique that is specifically directed at publicity rights, see M. Madow, “Private Ownership of Public Image: Popular Culture and Publicity Rights” (1993) 81 Calif. L. Rev. 125.

<sup>123</sup> A.G. Chronopoulos and S.M. Maniatis, “Property Rights in Brand Image: The Contribution of the EUIPO Boards of Appeal to the Free-riding Theory of Trade Mark Protection” in EUIPO (ed.), *20 years of the Boards of Appeal at EUIPO. Celebrating the Past, Looking Forward to the Future, Liber Amicorum* (Alicante: 2017), pp.147, 155–156. For an economic analysis and potential justifications for the free-riding theory, see A.G. Chronopoulos, “Legal and Economic Arguments for the Protection of Advertising Value Through Trade Mark Law” (2014) 4 Q.M.J.I.P. 256; and A. Griffiths, *An Economic Perspective on Trade Mark Law* (Cheltenham: *Edward Elgar*, 2011) pp.273–277.

<sup>124</sup> M.F. Grady, “A Positive Economic Theory of the Right of Publicity” (1994) 1 UCLA Ent. L. Rev. 97, 103–104.

<sup>125</sup> *Irvine v Talksport Ltd* [2002] EWHC 367 (Ch); [2002] E.M.L.R. 32.

<sup>126</sup> *Irvine v Talksport* [2002] E.M.L.R. 32 at [39] (Laddie J).

<sup>127</sup> *Irvine v Talksport* [2002] E.M.L.R. 32 at [38] (Laddie J): “If someone acquires a valuable reputation or goodwill, the law of passing off will protect it from unlicensed use by other parties. Such use will frequently be damaging in the direct sense that it will involve selling inferior goods or services under the guise that they are from the claimant. But the action is not restricted to protecting against that sort of damage. The law will vindicate the claimant’s exclusive right to the reputation or goodwill. It will not allow others to so use goodwill as to reduce, blur or diminish its exclusivity.”

<sup>128</sup> *L’Oréal SA v Bellure NV* [2007] EWCA Civ 968; [2008] E.C.C. 5 at [154]–[155].

<sup>129</sup> See, for instance, *Taittinger SA v Allbev Ltd* [1993] 2 C.M.L.R. 741; [1993] F.S.R. 641 CA (Civ Div) at 678.

<sup>130</sup> S.L. Dogan and M.A. Lemley, “A Search-Costs Theory of Limiting Doctrines in Trademark Law” in G.B. Dinwoodie and M. Janis (eds), *Trademark Law and Theory: A Handbook of Contemporary Research* (Cheltenham: Edward Elgar, 2008), pp.65, 82. For a critical appraisal, see I. Calboli, “Trade Mark Assignment ‘With Goodwill’: A Concept Whose Time Has Gone” (2005) 57 Fla. L. Rev. 771.

<sup>131</sup> Trade Marks Act 1994 s.26(4); see, generally, C. Morcom, A. Roughton and T. St Quintin, *The Modern Law of Trade Marks*, 5th edn (London: LexisNexis, 2016), para.11.5.

by the facts of the *Emanuel* case.<sup>132</sup> A famous fashion designer decides to retire early enough to thoroughly enjoy the fruits of her lifetime labour and sell her business along with its assets, including its goodwill and registered trade mark rights in her own personal name. The ECJ held that the very fact that the new operator of the business will be using a mark consisting of the well-reputed previous owner's name does not necessarily mean that consumers will be misled into thinking that the famous designer is still somehow actively involved in the business by contributing to its goals in some capacity.<sup>133</sup> It depends on the circumstances, as usual. As the transaction will take place in view of the prospect of the mark being revoked on the ground of it having become misleading, for instance, the respective rules interfere with the sale in the sense that they render it more difficult or complex by essentially imposing a condition upon the use of the property to be acquired. In that regard, the provisions related to misleading marks may occasionally function as inalienability rules.<sup>134</sup>

Inalienability may also serve distributional aims at the expense of efficiency goals.<sup>135</sup> Consider the example of zoning regulations that enhance the welfare of a group of citizens by keeping urban spaces open for common use but, at the same time, they may increase the cost of housing for other co-citizens in suburban areas. Legislators strive to achieve an optimal balance between distributional and efficiency considerations.

In *L'Oréal v Bellure*, Jacob LJ seems to have raised an argument of that kind. Criticising the ECJ's approach to the issues of law that arose in this dispute, he said:

“The ECJ's decision in this case means that poor consumers are the losers. Only the poor would dream of buying the defendants' products. The real thing is beyond their wildest dreams. Yet they are denied their right to receive information which would give them a little bit of pleasure; the ability to buy a product for a euro or so which they know smells like a famous perfume.”<sup>136</sup>

Of course, drawing the limits between property rights that are necessary to create the artificial scarcity associated with goods characterised by an aura of luxury and exclusivity and “areas of common use” so that less affluent consumers do not feel excluded is not an easy task. Quite often, however, the market forces attend to such problems themselves and perhaps in ways that are

much more efficient than regulatory or judicial intervention. Traders extend their product lines to create “affordable luxury brands”<sup>137</sup> more frequently than ever these days.<sup>138</sup>

As already suggested, the exceptions to the principle of exhaustion may be explained, at least partially, as inalienability rules driven by efficiency considerations. They serve the purpose of preserving reputational intangible values as goods stemming from a commercial source flow down the distribution channels to reach the ultimate consumer. Another efficiency consideration promoted by allowing the trade mark proprietor to oppose the further commercialisation of goods placed on the market with her consent is found in the generation of incentives for economic operators to market products differentiated by brand image,<sup>139</sup> luxury items and even Veblen goods satisfying demand for conspicuous consumption.<sup>140</sup> In conjunction with the free-riding theory of trade mark protection, the trade mark proprietor's limited authority to control downstream sales allows for the internalisation of the economic benefits accruing from the commercial exploitation of the advertising value she has created.

## Conclusion

In order to protect reputational interests of the trade mark proprietor, the law has recognised exceptions to the principle of exhaustion. The economic value that is protected may comprise both the image of the trade-marked good and the reputation of the commercial source signified by a given trade mark. Such expansion of the scope of trade mark rights that allows the trade mark proprietor to exercise some control over the further commercialisation of goods she has already placed on the market with her consent may be justified by reference to the protectable trade mark functions. It is predominantly the functions of advertising and investment that push towards the expansion of the exceptions to trade mark exhaustion. Despite the accessory nature of the quality function, considerations pertaining to perceived quality as conceptualised by marketing science have the same expansionist effect. The trade mark functions may indeed be extremely valuable as analytical instruments since they allow us to study the market effects of trade marks but the extent to which they enjoy legal recognition and protection is a matter that needs to be assessed in

<sup>132</sup> *Emanuel v Continental Shelf 128 Ltd* (C-259/04) EU:C:2006:215; [2006] E.T.M.R. 56.

<sup>133</sup> *Emanuel v Continental Shelf 128* [2006] E.T.M.R. 56 at [51].

<sup>134</sup> The very same case highlights the nature of trade mark rights as tradeable and monetisable assets that may be freely transferred even when the reputation that has attached to the mark is closely connected with the personality of the original trade mark proprietor. See J. Davis and S.M. Maniatis, “Trademarks, Brands, and Competition” in T. da Silva Lopes and P. Duguid (eds), *Trademarks, Brands, Competitiveness* (New York: Routledge, 2010), pp.119, 121–122 (engaging into a more thorough discussion of the economics of trade marks and the effect of their protection on competition).

<sup>135</sup> Calabresi and Melamed, “Property Rules, Liability Rules and Inalienability” (1972) 85 Harv. L. Rev. 1089, 1114–1115.

<sup>136</sup> *L'Oréal SA v Bellure NV* [2010] EWCA Civ 535; [2010] E.T.M.R. 47 at [14].

<sup>137</sup> J.-N. Kapferer, *Kapferer on Luxury: How Luxury Brands Can Grow Yet Remain Rare* (London: Kogan Page, 2015), p.45 (briefly discussing affordable luxury and consumer utility).

<sup>138</sup> See, for instance, M. Ishihara and Q. Zhang, “Balancing Exclusivity and Accessibility: Patterns of Brand and Product Line Extension Strategies in the Fashion Luxury Industry” (2017) 4 *Luxury* 31; A. Lo and M. Au Yeung, “Brand Prestige and Affordable Luxury: The Role of Hotel Guest Experiences” (2020) 26 *J. Vacat. Mark.* 247 (reviewing the landscape in the respective business sectors).

<sup>139</sup> S.J. Dilbary, “Famous Trademarks and the Rational Basis for Protecting ‘Irrational Beliefs’” (2007) 14 *Geo. Mason L. Rev.* 605.

<sup>140</sup> T.B. Veblen, *The Theory of the Leisure Class: An Economic Study of Institutions* (London: Macmillan, 1899); but see S. Scaifidi, “The Scholarship of Envy” in Sun, Beebe and Sunder (eds), *The Luxury Economy* (2015), p.249 (exculpating “conspicuous consumption” with examples from other disciplines).

light of the policy decisions implemented by a given trade mark statute or other overriding principles including the freedom of competition.<sup>141</sup> Within that framework, due consideration must also be paid to dynamic efficiencies promoting the effectiveness of competition. As already indicated, the justifications provided by the ECJ for recognising exceptions to the principle of exhaustion focus primarily on the commercial necessity to protect reputational values rather than implementing the legal concept of the trade mark functions. This article has

suggested that these exceptions to trade mark exhaustion operate as inalienability rules designed to protect reputational values from depletion and secure incentives for the production of such informational goods. Although the doctrine of exhaustion traces back to primal legal principles, such as the hostility against the impositions of restrictions to the alienation of chattels, it should at the same time be borne in mind that inalienability rules are quite frequently deployed by the law to achieve various forms of efficiencies.

<sup>141</sup> *Google France Sarl v Louis Vuitton Malletier SA, Google France Sarl v Viaticum SA; Google France Sarl v Centre national de recherche en relations humaines* (C-236/08 to 238/08) EU:C:2010:159; [2010] E.T.M.R. 30 at [102]; Opinion of AG Kokott, *Viking Gas* [2011] E.T.M.R. 58 at [50] onwards. See also A. Kur and M. Senftleben, *European Trade Mark Law: A Commentary* (Oxford: Oxford University Press, 2017), pp.14–25.