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European Patent Law and the Exhaustion Principle

Michael A. Gold†

The free movement of goods among Member States has been a guiding principle behind the development of the European Community ("EC"). Article 30 of the Treaty of Rome ("EEC Treaty" or "Treaty") prohibits Member States from quantitatively restricting imports from other Member States.¹ No State may prevent the import of goods from other Member States on economic grounds.

In contrast to the free movement provisions are the economic and legal principles underlying patent rights. The holder of a patent, in theory, has exclusive control for a fixed period of time over who is entitled to manufacture, buy, sell, use, and improve a patented product or process.² By guaranteeing to inventors the exclusive economic benefits of their inventions, patent rights encourage scientific and technological development, thereby improving a nation's standard of living.³

Attempting to reconcile the twin goals of promoting the free movement of goods while at the same time respecting a patent holder's right to restrict the movement of a patented good, the drafters of the EEC Treaty have exempted some forms of commercial and industrial property from the free movement clauses of the Treaty. Article 36 of the Treaty states that the Community's commitment to the free movement of goods

shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of . . . the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, con-

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¹ Treaty Est Eur Eco Comm, Art 30.

² See Arthur R. Miller and Michael H. Davis, *Intellectual Property: Patents, Trademarks, and Copyright in a Nutshell* ("Intellectual Property in a Nutshell") § 1:2 at 12 (West, 2d ed 1990).

³ EEC, Art 36.

stitute a means of arbitrary discrimination or a disguised restriction on trade between Member States.⁴

Thus, the Treaty limits the protection Member States may accord industrial and commercial property, and the European Court of Justice ("ECJ") has not hesitated to deny this protection when countries have attempted to use it to "arbitrar[ily] discriminat[e]" against products from another Member State.⁵ The Court has employed an "exhaustion-of-right" doctrine ("exhaustion") to justify such denials.

Exhaustion restricts patent protection to no more than the exclusive right to put a patented product or idea into circulation for the first time.⁶ Once a patentee decides to market his goods in a Member State, "the patentee has 'exhausted' his industrial property 'rights' regarding those goods," and he cannot use the patent to impede the subsequent movement of the goods within the Community.⁷ Exhaustion resolves the conflict between patent protection and the free movement of goods in favor of the latter.

This Comment examines the inherent conflict between the free movement of goods and patent protection. Part I explores the development of EC case law and evaluates the statutory provisions of the European Patent Convention ("EPC") and the Community Patent Convention ("CPC"). Part II discusses the development of United States patent law and compares this regime to the new European system. Finally, Part III examines the effect enactment of the CPC will have on exhaustion doctrine in the EC.

I. DEVELOPMENT OF EC PATENT LAW

A. The ECJ and Exhaustion

The seminal case interpreting Article 36 is a copyright case. In *Deutsche Grammophon Gesellschaft mbH v Metro-SB Grossmarkte GmbH & Co. KG*,⁸ the defendant purchased records distributed by the copyright owner's subsidiary in France and then

⁴ Id.

⁵ See Case 78/70, *Deutsche Grammophon Gesellschaft mbH v Metro-SB Grossmarkte GmbH & Co. KG*, 1971 ECR 487, 1971 CMLR 631; Case 15/74, *Centrafarm BV v Sterling Drug Inc.*, 1974 ECR 1147, 1974:2 CMLR 480; Case 193/83, *Windsurfing Intl. Inc. v Commission*, 1986 ECR 611, 1986:3 CMLR 489; Case 187/80, *Merck & Co. Inc. v Stephar BV and Petrus Stephanus Exler*, 1981 ECR 2063, 1981:3 CMLR 463.

⁶ *Centrafarm BV v Sterling Drug Inc.*, 1974 ECR at 1162, 1974:2 CMLR at 503.

⁷ *Generics (U.K.) Ltd. v Smith Kline & French Labs. Ltd.*, 1990:1 CMLR 416, 450 (English Court of Appeals).

⁸ 1971 ECR 487, 1971 CMLR 631.

sold them in Germany at prices that undercut the copyright owner's price structure.⁹ The owner sued for copyright infringement, and the ECJ held that the holder of an intellectual property right, once he sanctions its use in one Member State, thereby exhausts that right in the others. Because enforcing Deutsche Grammophon's copyright would impair the free movement of goods, the ECJ ruled that the "arbitrary discrimination or [] disguised restriction" language of Article 36 required application of an exhaustion doctrine to cases involving intellectual property rights.¹⁰

The ECJ extended this analysis to patent law in *Centrafarm v Sterling Drug*.¹¹ In this case, Sterling, a drug manufacturer, had patented a process for preparing acidum nalidixicum in several Member States.¹² The patent holder placed a drug made with this process on the market in both West Germany and Great Britain. Centrafarm then imported the patented drug from Germany into the Netherlands, thereby undercutting the patent holder's price in the latter country. The holder sued to enjoin Centrafarm's marketing efforts.¹³

Following the logic of *Deutsche Grammophon*, the European Court of Justice stated that

Inasmuch as it provides an exception to one of the fundamental principles of the Common Market, *Article 36 in fact only admits of derogations from the free movement of goods where such derogations are justified for the purpose of safeguarding rights which constitute the specific subject matter of this property*. In relation to patents, the specific subject matter of the industrial property is the guarantee that the patentee, to reward the creative effort of the inventor, has the exclusive right to use an invention with a view to manufacturing industrial products and putting them into circulation for the first time, . . . as well as the right to oppose infringements.¹⁴

⁹ 1971 ECR at 503-04, 1971 CMLR at 634-35.

¹⁰ For a more complete discussion of *Deutsche Grammophon*, see Comment, *Copyright Protection of Software in the EC: The Competing Policies Underlying Community and National Law and the Case for Harmonization*, 75 Cal L Rev 633, 635-636 (1987); Diana Guy and Guy I. F. Leigh, *The EC and Intellectual Property* 121-27 (Oceana Publications, 1981).

¹¹ 1974 ECR 1147, 1974:2 CMLR 480.

¹² *Id.*, 1974 ECR at 1149, 1974:2 CMLR at 484.

¹³ *Id.*

¹⁴ *Id.*, 1974 ECR at 1162, 1974 CMLR at 503 (emphasis added).

The ECJ thus held that a patent protects only certain manufacturing rights and only applies to the initial introduction of a product.¹⁵ As in *Deutsche Grammophon*, the ECJ resolved the conflict between a patent holder's rights and the free movement of goods in favor of the latter,¹⁶ and it reaffirmed that a patent holder's rights are exhausted once he places the product on the market in any Member State.¹⁷

The ECJ extended this holding in *Merck & Co. Inc. v Stephar BV*.¹⁸ Merck owned the patent to the drug "Moduretic" in the Netherlands.¹⁹ It also sold Moduretic in Italy, which prohibited patenting of pharmaceutical products.²⁰ Stephar bought supplies of Moduretic in Italy at a low price, imported them into the Netherlands, and thereby undercut Merck's price. Although Merck could not have patented Moduretic in Italy, the ECJ did not find this distinction significant.

The Court noted that "Article 36 admits of . . . a derogation [from the free movement of goods] only in so far as it is justified for the purpose of safeguarding rights which constitute the specific subject matter of that property[.]"²¹ It thus rejected Merck's argument that patent rights exist solely to protect patentees from Stephar-type behavior.²² A person granted a patent is merely given the opportunity to obtain a financial reward from the patented product; the patent does not guarantee that its holder will actually collect such a reward.²³ Thus, the ECJ concluded that when a patentee voluntarily introduces a product into a market where patents are not available, the patentee has exhausted his property rights.

¹⁵ Case 15/74, *Centrafarm BV v Sterling Drug Inc.*, 1974 ECR 1147, 1162, 1974:2 CMLR 480, 503.

¹⁶ *Id.*, 1974 ECR at 1163, 1974:2 CMLR at 505.

¹⁷ See Guy & Leigh, *The EC and Intellectual Property* at 133 (cited in note 10); Victor Vandebek, *Realizing the European Community Common Market By Unifying Intellectual Property Law: Deadline 1992*, 1990 BYU L Rev 1605, 1621.

¹⁸ Case 187/80, 1981 ECR 2063, 1981:3 CMLR 463.

¹⁹ *Id.*, 1981 ECR at 2079, 1981:3 CMLR at 465.

²⁰ *Id.* Although Italian law subsequently allowed patents on pharmaceutical products, this particular property was still barred from an Italian patent because it failed to satisfy the "novelty" requirement for obtaining a patent.

²¹ *Id.*, 1981 ECR 2080, 1981:3 CMLR at 480.

²² The Advocate General argued that such a reading was foreclosed by the *Centrafarm* holding. Case 187/80, *Merck & Co. Inc. v Stephar BV*, 1981 ECR 2063, 2089, 1981:3 CMLR 463, 470.

²³ *Id.*, 1981 ECR at 2081, 1981:3 CMLR at 481 ("That right of first placing a product on the market enables the inventor, by allowing him a monopoly in exploiting his product, to obtain the reward for his creative effort without, however, guaranteeing that he will obtain such a reward in all circumstances.").

In *Deutsche Grammophon*, *Centrafarm*, and *Merck* the patent protection question turned on the marketing of particular goods "put on the market" by the patent holder.²⁴ A patent holder's marketing rights were limited to the "exclusive right to use an invention with a view to . . . putting [products] . . . into circulation for the first time[.]"²⁵ Yet, these cases leave unresolved the scope of a patent holder's manufacturing rights.

In 1986, the ECJ addressed the question of manufacturing rights in *Windsurfing International v European Community Commission*.²⁶ *Windsurfing International* licensed various European companies to develop and distribute its patented product.²⁷ It retained the right to terminate the agreements if the licensees manufactured products in or distributed them to countries in which the company did not hold valid patents.²⁸ The Commission reviewed these licensing agreements and invalidated them as inconsistent with the EEC Treaty and subsequent law.²⁹ The ECJ agreed.³⁰

The Court held that sweeping agreements preventing the export of goods to, or manufacture of goods in, a Member State that does not have patent protection are contrary to the free movement of goods.³¹ A licensor that prohibits licensees from manufacturing products in a country where it has no patent protection impermissibly burdens competition.³² Thus, *Windsurfing* could not use licensing agreements to extend its patent protection to countries in which it did not possess a patent.³³

This holding furthers the free movement of goods by limiting companies' ability to control the unauthorized export of their products.³⁴ Taken together, *Grammophon* and *Windsurfing* dra-

²⁴ These cases are unclear on the question of whether a third party would be barred from manufacturing a product in a country where no patent protection is available and then importing that product into a country where someone-else owns a valid right. However, the *Merck* Court interprets *Centrafarm* as justifying such a restriction. 1981 ECR 2063, 2080, 1981:3 CMLR 463, 480.

²⁵ *Centrafarm v Sterling Drug*, 1974 ECR 1147, 1162, 1974:2 CMLR 480, 503 (emphasis added).

²⁶ See Case 193/83, *Windsurfing Intl. Inc. v Commission*, 1986 ECR 611, 1986:3 CMLR 489.

²⁷ *Id.*, 1986 ECR at 645, 1986:3 CMLR at 524.

²⁸ *Id.*, 1986 ECR at 646-47, 1986:3 CMLR at 526.

²⁹ See Vandebek, 1990 BYU L Rev at 1622 (cited in note 17).

³⁰ *Windsurfing Intl.*, 1986 ECR at 662, 1986:3 CMLR at 539.

³¹ *Id.*

³² *Id.*

³³ Vandebek, 1990 BYU L Rev at 1622 (cited in note 17).

³⁴ As an illustration, suppose that company X has a patent on widgets in the United States. Company X then licenses company Y to produce widgets in France, but not in Ger-

matically narrow the protection the EC affords patent holders: *Grammophon* establishes the principle of exhaustion, by which a company loses patent protection after introducing its product; and *Windsurfing* prevents a company from using contractual agreements to give extraterritorial effect to its patented manufacturing rights.

Yet, by giving such broad scope to the Community's free movement principles, these decisions may run afoul of another fundamental goal of the EC—raising European standards of living. Patent protection, by promoting the development of new technologies and products, improves a country's standard of living.³⁵ However, the limited protection given to patent holders in the EC may either discourage them from marketing products in European countries, or it may discourage Europeans from inventing their own products.³⁶ Neither result will improve the European standard of living.

B. Towards a Unitary Patent System in the EC

Several European nations signed a Munich Convention on patent law on October 5, 1973.³⁷ This Convention, better known as the European Patent Convention ("EPC"), allows an inventor to apply for patent protection in multiple nations by submitting a single application (in one language) to one Member State's patent office.³⁸ An applicant indicates the countries for which it desires patent protection and receives parallel European patents for each of these countries.³⁹ Each patent issued under the EPC gives its holder rights equivalent to those enjoyed by a holder of a national pat-

many, where company X does not have a valid patent. After *Windsurfing*, this covenant restricting widget production in Germany would be invalid and, therefore, company Y could lawfully produce the product in Germany. Since company X does not have a patent in Germany, company Z could now obtain the product in Germany and import the product back into France. Company X would have no remedy against company Z due to *Grammophon* exhaustion principles.

³⁵ See Ernest Bainbridge Lipscomb III, 2 *Walker on Patents* § 8:3 at 485 (The Lawyer's Co-op, 3d ed 1985).

³⁶ See Michael Welbroeck, *Competition, Integration and Economic Efficiency in the EC From the Point of View of the Private Firm*, 82 Mich L Rev 1439, 1444-45 (1984).

³⁷ Convention on the Grant of European Patents, ("European Patent Convention" or "EPC"), 3 Common Mkt Rptr (CCH) ¶ 5503 (1973).

³⁸ Id, arts 75-86, 3 Common Mkt Rptr (CCH) at ¶ 5579.

³⁹ European patents give their holders protection for 20 years following the date of issue. Id, art 60(1), 3 Common Mkt Rptr (CCH) at ¶ 5567 (1973).

ent.⁴⁰ Thus, the EPC does not create a unitary patent regime; it merely simplifies and centralizes the patent application process.

The EC once again convened to discuss patent law in 1975.⁴¹ These discussions resulted in a proposed Community Patent Convention ("CPC") that would create a unitary patent system that would give patent holders uniform protection in all Member States.⁴² In short, a single, Community patent would allow its holder to trade with all Member States, secure in the knowledge that a decision to market in one country would not jeopardize the patent holder's rights in another.

The Member States, however, have not ratified the CPC. Not all have been willing to acknowledge the value of vesting a centralized European Patent Organization ("EPO") with exclusive jurisdiction over all patent law matters and disputes.⁴³ For example, the Irish government has stated that a constitutional amendment is required before it could cede such authority to the EPO.⁴⁴ Similar concerns have also prevented the Danish Parliament from ratifying the CPC.⁴⁵

Because Ireland and Denmark have refused to ratify the CPC, the Community has attempted to find another means, absent unanimous ratification, by which it can make the CPC binding law. At a third patent law conference in Luxembourg in 1989,⁴⁶ the Member States apparently found such a means: they agreed that if the CPC was not unanimously ratified by the end of 1991, they could (by unanimous vote) enact a more limited version of the CPC that would apply to all Member States except Ireland and

⁴⁰ *Id.*, art 64, 3 Common Mkt Rptr (CCH) at ¶ 5568 ("A European patent shall . . . confer on its proprietor from the date of publication of the mention of its grant, in each Contracting State in respect of which it is granted, the same rights as would be conferred by a national patent granted in that State"). See Vandebek, 1990 BYU L Rev at 1616 (cited in note 17).

⁴¹ Convention for the European patent for the common market, 1976 OJ L17:1. In 1989, a third Patent Convention was convened, producing an amended version of the Community Patent Convention. 1989 OJ L401:1 ("Community Patent Convention" or "CPC").

⁴² The CPC also allows an applicant to file a single application for such a unitary patent. However, Member States would still have the power to grant their own individual patents. Community Patent Convention, art 5, 1989 OJ at L401:10 ("This Convention shall be without prejudice to the right of the Contracting States to grant national patents").

⁴³ See Vandebek, 1990 BYU L Rev at 1614 n 25 (cited in note 17).

⁴⁴ *Id.*

⁴⁵ *Id.* The Danish Parliament has already considered and rejected the CPC three times. One possible solution to the problem might be to combine the validity and injunctive proceedings and grant jurisdiction to the national courts. See *id.*

⁴⁶ Community Patent Convention, 1989 OJ at L401:1 (cited in note 41).

Denmark.⁴⁷ Since Ireland and Denmark generally support enactment of a Convention that does not bind them,⁴⁸ the revised CPC will probably go into force at the end of 1992.

The CPC will not entirely displace the national patent system. Article 5 states that "[t]his Convention shall be without prejudice to the rights of the Contracting States to grant national patents."⁴⁹ Accordingly, Europe will have two parallel patent systems—at least during the short term. In the long term Member States can force the elimination of national patent offices by unanimous vote. Thus, the CPC will probably become the sole governing European patent law.

Once the CPC is ratified, substantive EC patent law will remain dependent on some provisions of the EPC.⁵⁰ However, the CPC does seek to create a unitary Community patent and, towards that end, it contains its own important substantive rules of European patent law, rather than merely borrowing from national law.⁵¹ Thus, article 25 of the CPC states that

A Community patent shall confer on its proprietor the right to prevent all third parties not having his consent:

(a) from making, offering, putting on the market or using a product which is the subject-matter of the patent, or importing or stocking the product for these purposes;

(b) from using a process which is the subject-matter of the patent or . . . from offering the process for use within the territories of the Contracting States;

(c) from offering, putting on the market, using, or importing or stocking for these purposes the product obtained directly by a process which is the subject matter of the patent.⁵²

⁴⁷ Protocol on a possible modification of the conditions of entry into force of the Agreements relating to Community patents, art 1, 1989 OJ L401:51.

⁴⁸ Albrecht Krieger, *The Luxembourg Convention on the Community Patent-A Challenge and a Duty*, 19 Intl Rev Indus Prop Copyright L 143, 150-51 (1988).

⁴⁹ Community Patent Convention, art 5, 1989 OJ at L401:10 (cited in note 41).

⁵⁰ For example, CPC article 23, in discussing the right to patent under the proposed regime, refers back to EPC article 60(1). See *id.*, art 23, 1989 OJ at L401:14.

⁵¹ For example, regarding a right to a patent under the CPC, article 23 refers back to article 60(1) of the EPC. *Id.*

⁵² *Id.*, art 25, 1989 OJ at L401:14. Article 26 provides similar provisions prohibiting the indirect use of a product or process, and article 27 provides for certain limits to the effects of the Community patent.

II. EUROPEAN LAW THROUGH A UNITED STATES POLICY LENS

A. United States Patent Policy

The United States grants a patent to the inventor of "any new and useful process, machine, manufacture, or composition of matter, or any new and useful improvement," subject to certain limitations.⁵³ To receive a patent, an applicant must provide a complete description of the new invention that discloses how it works and how it can be reproduced.⁵⁴ In return, the successful applicant receives the exclusive right to make, use, or sell the invention for a period of seventeen years.⁵⁵

The Founders gave United States patent law a constitutional foundation in Article I, Section 8, Clause 8: "The Congress shall have Power . . . *To promote the Progress of Science and useful Arts*, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries"⁵⁶ Accordingly, subsequent patent legislation took the promotion of technological and scientific development as its central objective.⁵⁷

In *Kewanee Oil Company v Bicorn Corporation*, the Supreme Court explained that patents give their holder the "right of exclusion" in order to induce "inventors to risk the enormous costs in terms of time, research, and development."⁵⁸ In other words, "the benefit to the public or community at large was . . . doubtless the primary object in granting and securing [the patent] monopoly."⁵⁹ Therefore, patent law is primarily concerned with promoting the public interest, rather than enforcing an inventor's temporary monopoly.⁶⁰ Short term monopolies are granted only because they

⁵³ 35 USC § 101 (1990).

⁵⁴ 35 USC §§ 111, 112 (1990).

⁵⁵ 35 USC § 154 (1990).

⁵⁶ US Const, Art I, § 8, cl 8 (emphasis added).

⁵⁷ Congress exercised its authority to enact patent legislation for the first time in the Patent Act of 1790. In 1836, Congress created the Patent Office to act as a central authority vested with the power to examine patents and to determine whether applicants satisfied the requirements of the statute. See also, *Kewanee Oil Co. v Bicorn Corp.*, 416 US 470, 480 (1974).

⁵⁸ *Id.*

⁵⁹ *Kendall v Winsor*, 62 US 322, 328 (1858). See also, Lipscomb, 2 *Walker on Patents* § 8.3 at 485 (cited in note 35) ("the paramount concern of patent law is the preservation of the public interest").

⁶⁰ *Kendall v Winsor*, 62 US at 329 ("Whilst the remuneration of genius and useful ingenuity is a duty incumbent upon the public, the rights and welfare of the community must be fairly dealt with and effectually guarded.").

benefit the public by encouraging and promoting industry and science.⁶¹

However, United States patent law also distinguishes between the creation of monopolies and their effect, labeling the latter a property right.⁶² Thus, "patent[s] are not to be regarded as monopolies, created . . . at the expense and to the prejudice of all the community except the persons therein named as patentees, but as public franchises granted to the inventors of new and useful improvements[.]"⁶³ Since patent rights are "public franchises," the exclusive right granted to the patent holder is "patent property."⁶⁴ This means that the holder has the exclusive right to "make, use, or sell" the patented product, but that right is limited to protect the public interest in promoting freedom of competition and exchange of useful ideas.

Thus, two general theories inform United States patent law: (1) the contract or "bargain" theory, and (2) the "natural rights" theory.⁶⁵ The bargain theory holds that a patent is essentially a contract between the public and the inventor. The inventor develops the product for the public good and then turns it over to the public. In exchange the inventor receives the exclusive right to produce, distribute, and sell it.

Conversely, the natural rights theory maintains that "the product of mental labor is by right the property of the person who created it."⁶⁶ The inventor retains all rights to the invention, and he has no duty to disclose anything. He must be paid to disclose. Government encourages such disclosure by agreeing to enforce the patent holder's rights, thereby ensuring his right to profits from the invention.

In summary,

One can speak in at least two different languages about law, patent or otherwise. In the vocabulary of moral entitlement, patents defend inventors' just desserts. But in the vernacular of instrumental social engineering, patents

⁶¹ Lipscomb, 2 *Walker on Patents* § 8:3 at 485-86 (cited in note 35). See also, *Lackner Co. v Quehl Sign Co.*, 145 F.2d 932, 934 (6th Cir 1944).

⁶² Lipscomb, 2 *Walker on Patents* § 8:4 at 488-90 (cited in note 35).

⁶³ *Seymour v Osborne*, 78 US 516, 533 (1871).

⁶⁴ See Lipscomb, 2 *Walker on Patents* § 8:4 at 489-90 (cited in note 35).

⁶⁵ For a more complete discussion of the theories, see Miller & Davis, *Intellectual Property in a Nutshell* § 1.3 at 14-18 (cited in note 2).

⁶⁶ *Id* at 15.

encourage research and development and ultimately improve consumer welfare.⁶⁷

Taken together, these theories provide a useful framework for analyzing the development of European patent law.

B. The United States Model and European Law

The texts of United States and European patent codes differ with respect to the rights given patent holders. The United States gives patent holders the right to "exclude others from making, using or *selling* the invention,"⁶⁸ whereas the Community's CPC article 25 gives patent holders the right to "prevent" third parties from "making, offering, *putting on the market* or using" a patented product or process.⁶⁹ The distinction between the United States "selling" language and the European "putting on the market" language underscores the two regimes' different patent philosophies.

The United States' "selling" language preserves the patent holder's exclusive right to "market" or "sell" the item for the entire statutory period. In contrast, the EC phrase "putting on the market" indicates that a person has the right to "market" or "sell" the item or process only once.⁷⁰ United States patent law has no similar provision and has not incorporated the principle of exhaustion.⁷¹

⁶⁷ John Shepard Wiley Jr., *Bonito Boats: Uninformed but Mandatory Innovation Policy*, 1989 S Ct Rev 283, 296.

⁶⁸ 35 USC § 154 (1990) (emphasis added).

⁶⁹ Community Patent Convention, art 25, 1989 OJ at L401:14 (cited in note 41) (emphasis added).

⁷⁰ The EC codified the exhaustion effect of a patent in article 28 of the CPC. See *id.*, art 28, 1989 OJ at L401:15.

⁷¹ An interesting parallel does exist, however, between U.S. copyright law and the exhaustion doctrine. Under U.S. copyright law, "the owner of a particular copy or phonorecord lawfully made under the copyright statute, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord." 17 USC § 109(a) (1990).

This "first sale" doctrine provides that once someone buys a copy of copyrighted material, that person has complete ownership over that copy of the copyrighted material. Although that owner cannot reproduce the material, she or he can dispose of it however that person wishes. Once a copyright owner consents to the sale of a particular copy of the owner's work, the purchaser of that copy is free to distribute that copy as the purchaser chooses. Melville B. Nimmer and David Nimmer, 2 *Nimmer on Copyright* § 8.12(b)(1) at 130 (Matthew Bender, 1991). Thus, like the exhaustion doctrine, the first sale doctrine operates to allow the owner of a copyright to place a particular item on the market only once.

C. The Conflict between Exhaustion and Protection

1. *Exhaustion is antithetical to patent protection.*

The bargain and natural rights theories demonstrate how exhaustion undermines the effectiveness of patent law. Exhaustion is arguably consistent with the bargain theory: an item is only patented for the purpose of promoting the "public good." When the patent is exhausted, the protected private right has been successfully defended, and the public interest is now better served by free trade in the patented good.

Yet, exhaustion ensures that, in practice, patent holders will not distribute their products to nations where patent protection does not exist. Inventors will distribute the patented process or item only to areas where it cannot be imported back into patent-protected nations. This means, for example, that pharmaceutical producers would not market products in Italy if Italy does not grant patents for such products.⁷² More importantly, a patent right should not expire prior to the conclusion of its time period. If the law grants an inventor a patent for twenty years,⁷³ then it should not allow his competitors to shorten the life of the patent by resort to importation.

Whereas the bargain theory of patent law may provide some support for exhaustion, the natural rights theory argues strongly against such a result. A patent holder's "natural right" to the fruits of his or her labor should not be frustrated by the clever use of import laws. One should not profit from the original patent holder's labor without bearing some of the costs of that labor. The natural right of the patent holder thus trumps any claim asserted by an importer.

This argument may prove too much. A firm does not have an absolute right to the item or process it patents; its right is temporally limited. Thus, at some point the patent holder properly loses its exclusive right to the fruits of its labor. At some point exhaustion becomes not only necessary, but desirable.

Moreover, exhaustion may not be quite so devastating in practice. If a Member State wants to ensure continued development and distribution of scientific innovation, it merely has to raise its patent protection to EC levels. As long as Member States protect

⁷² A buyer of a patented product in an EC nation could then resell the product in a non-patented country. Thus, the product would be distributed in the non-patented country, assuming the economic incentive existed to promote such a secondary market.

⁷³ European Patent Convention, art 63, 3 Common Mkt Rptr (CCH) at ¶ 5567 (cited in note 37).

patent holders to the same extent as the EC, inventors will not be deterred from distributing products in their countries. Since each nation has the power to correct the apparent discrepancy, the erosion of patent protection caused by exhaustion may not be extreme.

2. *Exhaustion greatly reduces a patent's value.*

Perhaps more troubling, though, exhaustion greatly decreases a patent's value. By allowing a third party to import a patented product into a Member State, exhaustion devalues the patent holder's exclusive right to control the distribution of the patented product. Further, if article 28 of the CPC reduces the level of patent protection provided, then the economic value of the patent is even lower.⁷⁴

Proponents of the exhaustion principle reject these economic concerns. They contend that the Community should retain exhaustion because patent protection exists solely for the public's benefit. Thus, that exhaustion diminishes the economic value of a patent to its holder is irrelevant; patent policy is not concerned with the value of the patent to its holder. This cannot withstand close scrutiny. Patent policy depends on creating the proper incentives to promote industrial and technological innovation. To the extent that exhaustion diminishes the value of a patent, private incentives to invent are dampened. To encourage private innovation, patents must be sufficiently protective.

Exhaustion proponents may concede that the private, economic value of a patent is important. Nonetheless, they may counter that the "free movement of goods" outweighs such private incentive concerns. Without exhaustion, the European patent system might overprotect a patent holder's rights, and it might reinforce the protectionist trade tendencies of some Member States. Moreover, such advocates contend that exhaustion merely attempts to promote a more equitable tradeoff between the public interest and private incentives. Yet, exhaustion seems a rather indirect means of achieving a more optimal tradeoff.

Even patents subject to exhaustion are not worthless. The holder controls the marketing of a patented product or process. Thus, it can choose not to market the product in a way that might place its interests at risk. Moreover, since the ECJ distinguishes

⁷⁴ See text at notes 75-79.

between "putting on the market" and manufacturing, the patent holder still controls manufacture of the product.⁷⁵

III. EXHAUSTION AND THE CPC

If the CPC is enacted, two general objections to exhaustion will remain: (1) textually, the CPC's exhaustion provisions may destroy domestic patent protection; and (2) exhaustion is unnecessary under the envisioned Community Patent Convention.

A. Exhaustion Compromises Domestic Patent Protection

Read literally, CPC article 28 applies exhaustion to domestic patent infringement disputes. Indeed, article 28 may extend the scope of exhaustion beyond that given it by the ECJ. The ECJ at least limited exhaustion to cases concerning trade *among* Member States.⁷⁶ However, article 28 of the CPC contains no such limitation.⁷⁷ Thus, it might be interpreted to mean that as soon as a product is placed on a Member State's market by the patent holder, anyone in that country could appropriate the patented product or process and exploit it for his or her own benefit.

Such a result would be absurd, and the ECJ would probably not give CPC article 28 such a construction. However, the ECJ might be inclined to read article 28 to permit partial abrogations of patent protection. For example, if a patent holder grants a license to another party for a certain "field of use" of the patent, the expansive language of article 28 could lend credence to an argument that the holder has in effect placed the patent "on the market" and thus the "field of use" restriction is unenforceable.⁷⁸ Again, this result is not mandated by article 28's language. However, the CPC seems to contemplate stretching the meaning of article 28 be-

⁷⁵ The European Economic Community should consider alternate analytical tools for valuing the economic cost of the exhaustion principle. The value of a European patent might be evaluated using Professor Kaplow's model regarding the tension between American patent law and antitrust law. See Louis Kaplow, *The Patent-Antitrust Intersection: A Reappraisal*, 97 Harv L Rev 1813 (1984). Professor Kaplow develops a ratio analysis to compare the costs and benefits inherent in balancing conflicting antitrust and patent laws. The EC could adopt this model to provide a framework for assessing the economic cost tolled by adherence to a free-movement principle. However, attempted evaluation and application of Kaplow's model to the patent context exceeds the scope of this Comment.

⁷⁶ See Case 51/75, *EMI Records Ltd. v CBS United Kingdom Ltd.*, 1976 ECR 811, 1976:2 CMLR 235.

⁷⁷ Community Patent Convention, art 28, 1989 OJ at L401:15 (cited in note 41).

⁷⁸ See Guy & Leigh, *The EC and Intellectual Property* ¶¶ 14.28-14.34 at 248-49 (cited in note 10).

yond the free movement concerns articulated in Articles 30 and 36 of the EEC Treaty.

European courts can avoid construing exhaustion too expansively by referring to the last clause of article 28. This clause states that the provision does not apply where "there are grounds which, under Community law, would justify the extension to such acts of the rights conferred by the patent."⁷⁹ The ECJ should limit article 28's scope by interpreting its last clause to make exhaustion applicable to only those situations envisioned by the EEC Treaty.⁸⁰ Moreover, this would be consistent with the Community's established case law.⁸¹

B. Ratification of the CPC Renders Exhaustion Unnecessary

Exhaustion becomes superfluous once the CPC displaces national patent law. The ECJ developed exhaustion to promote the free flow of goods among Member States. Yet, the CPC creates a unitary patent for the entire EC, and once it takes effect, patents can no longer create national barriers to free trade. Someone who obtains a Community Patent would be protected in all Member States (except Ireland and Denmark) and would never face the problem of competitors undercutting price by intra-Community export.

For example, if X has developed a new widget and wants to market it in France and Italy, even though the national law of Italy does not give patent protection to widgets, X would have Community patent protection in both France and Italy under the CPC. Thus, X could protect its Community patent rights in Italy and every other Member State subscribing to the CPC.

Political obstacles, however, may prevent Europe from realizing the promise of a unitary patent system in the near term. First, the CPC contains a transitional period, during which Community Patents and European national patents will coexist. During this period, the Community may employ exhaustion to regulate interaction between Member States and their patent laws.⁸² Second, Ireland and Denmark have been unwilling to ratify the CPC. If a

⁷⁹ Community Patent Convention, art 28, 1989 OJ at L401:15 (cited in note 41).

⁸⁰ See *EMI Records Ltd. v CBS United Kingdom Ltd.*, 1976 2 CMLR 235, 266.

⁸¹ See Guy & Leigh, *The EC and Intellectual Property* ¶¶ 14.28-14.34 at 248-49 (cited in note 10).

⁸² Even during this transitional period, however, CPC article 28 exhaustion seems unnecessary because it applies only to those patents issued by the Community. Where an inventor possesses a Community patent, he need not worry about price undercutting via intra-Community export. Any exporters would be required to respect the Community patent, and

more limited CPC is enacted which excludes Ireland and Denmark, then exhaustion might be applicable in certain circumstances. For example, Community patented products distributed in Denmark or Ireland would lack patent protection, and thus could be imported back into a CPC member. However, if Denmark and Ireland already give patent holders greater protection than the EC, then exhaustion would presumably have no effect.⁸³

CONCLUSION

Exhaustion doctrine contradicts the primary policy concerns underlying patent law. It perverts incentives and may distort intra-Community trade to the extent valuable processes or products are not directly distributed to Member States that do not provide adequate patent protection. Moreover, ratification of the CPC would eliminate any practical or theoretical need for exhaustion. Thus, the EC needs to reexamine the scope, effect, and purpose of the exhaustion doctrine before it makes it a part of the CPC.

The EC should remove exhaustion from the CPC's provisions. Although radical, such a solution makes the most sense. The exhaustion doctrine is unnecessary once a Community patent system is established. If the need should arise, exhaustion could be reincorporated into the CPC by Community legislation or ECJ decisions.

Of course, the EC would benefit from ratifying the CPC even if it contains exhaustion provisions. Because exhaustion should prove unnecessary under the CPC, it should disappear after the transitional period concludes. The promise of a unitary patent system will be fully realized when the Member States accept the Community patent system and dismantle their own patent laws. However, until that day, exhaustion should be opposed, for it may discourage the movement of valuable technologies among European nations.

thus they could not obtain a competitive advantage by purchasing in one Member State and exporting to another. Patent holders would, therefore, have nothing to fear from exhaustion.

⁸³ Moreover, interpreted literally, article 28 would not apply because its text only applies to actions done "within the territories of the *Contracting States*." Community Patent Convention, art 28, 1989 OJ at L401:15 (cited in note 41) (emphasis added). Thus, CPC exhaustion might not apply to transactions between CPC members and Denmark and Ireland.