Selective distribution networks and parallel imports within EU countries

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The aim of this article is to answer the following question: can a producer or a national exclusive distributor operating a selective distribution network in one of the Member States – forming part of a broader EU selective distribution network, oppose the sales in that Member State of products belonging to this network and put on the market as a result of parallel imports?

The general rule is the free movement of goods

First, let me make an important distinction: the rule within the European Union is the free movement – and thus also the parallel import – of goods, while the possibility of legally fighting this phenomenon is the exception. It must be pointed out that under Art. 101 of the TFEU (Treaty on the Functioning of the European Union) "***All agreements between undertakings, decisions by associations of undertakings and concerted practices which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the internal market are prohibited***", and in particular those which "***c) share markets…***". The German Volkswagen Group knows something about it. The Volkswagen Group, for having in a continuous, detailed and substantial manner opposed the parallel exports of its vehicles from Italy to Austria and Germany (from 1993 to 1996), was at the time imposed to pay[1] by the European Commission a fine of 102 million ECU (1 ECU = 1 Euro), subsequently 'reduced' to 90 million Euros by the Court of First Instance of the European Communities with the judgment of 6 July 2000, later confirmed by the European Court of Justice (ECJ) on 18 September 2003.

It is always possible to invoke trademark infringement in case of parallel imports from non-EU countries

[1] The date was 28 January 1998.

In the case of parallel imports of goods from a country outside the European Union (or the EEA – European Economic Area, which actually extends our area of interest consisting of 27 Member States to also include Iceland, Norway and Liechtenstein), the trademark owner can exercise his rights to oppose the introduction in the European Union of products bearing his trademark, even if the same were legitimately put on the non-EU market by himself or with his consent [2].

In other words, in such cases the trademark owner does not exhaust his trademark rights with the placing, for the first time by unauthorized third parties, of the products on the non-EU market, but he can also subsequently exercise them.

Member States are not free to legislate on the subject and thus must respect the principle, according to which, if a product was introduced in the EEA market without the trademark owner's consent, the owner may oppose the resale of said product in such market [3].
Conversely, the trademark owner cannot oppose it if he has given his consent to the sale in the EEA of products put by himself on the non-EEA market and such consent may be inferred "*from facts and circumstances prior to, simultaneous with or subsequent to*..."; however, the law severely limits the cases in which such a consent may be considered 'tacitly' inferred and, in particular, this can never be deduced from the following circumstances [4]:

- failure to communicate to all subsequent non-EU purchasers his opposition to the marketing of products in the EEA;
- failure to indicate on the products the prohibition to market them in the EEA;
- transferral by the trademark owner of the property of the products bearing the trademark without imposing contractual restrictions, in the presence of a law applicable to transfer contracts under which the transfer necessarily includes the unrestricted right to subsequently sell the products in the EEA market.

Parallel imports within EEA countries and selective distribution networks

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[2] This principle has been last reaffirmed by Art. 7.1 of Directive 2008/95/EC, which will be discussed later.
[3] ECJ - Silhouette case C-355/96 of 16/07/1998.
[4] ECJ - Levi Strauss case C-414/99 of 20/11/2001.

The rule seen above relates to parallel imports from non-EEA countries, but it does not apply in the case of parallel imports within EEA countries, as we will see below. In fact, in the EEA applies the principle of Community exhaustion of trademark rights with the result that this, with certain exceptions, cannot be invoked against those who market products imported in parallel from another EEA country. The main (but not only) exception to this principle is the existence of a selective distribution network.

The possibility for European operators to set up selective distribution networks, which enjoy some exemptions in relation to the standard, tighter rules of the European antitrust authority, is provided for by Regulation (EU) No. 330/2010, in force from 1 June 2010 to 31 May 2022 (hereafter the 'Regulation').

Like all Regulations, it is directly addressed at citizens, individuals and legal persons resident in the diverse Member States of the EU and have binding legal status on national governments and on all the authorities of each Member State, thus including national courts which are required to interpret and apply national laws in compliance with current Regulations.

The Regulation concerns, with a few exceptions, only the vertical agreements between non-competing undertakings (such as, for example, the agreements between Philips and its distributors and not the 'horizontal' agreements between Philips and Sony, Samsung and/or other competitors).

These agreements benefit from the exemptions provided for by the Regulation (despite some content that would normally be prohibited) if:

- they do not include fundamental restrictions on competition (more on which below);
- the market share held by the seller does not exceed 30% of the relevant market on which it sells the contract goods or services;
- the market share held by the buyer does not exceed 30% of the relevant market on which it purchases the contract goods or services.

As said above, the implementation of a selective distribution system makes it possible, under certain conditions, to derogate from the prohibition of exclusive rights and from a number of other restrictions otherwise provided for in European competition law, as follows:

➢ Examples of clauses normally prohibited <u>but exempted</u> in the light of the Regulation:

- **supplier's obligation to sell the contract products only to the selected resellers;**

- **reseller's obligation to purchase the contract products only from the supplier;**
- **resellers' prohibition to sell to other resellers NOT belonging to the selective distribution network;**
- **resellers' prohibition to actively seek customers outside their assigned area.**

➢ Examples of clauses nevertheless prohibited in the light of the Regulation:

- **prohibition to sell to end users** (save the case of wholesalers);
- **prohibition to meet unsolicited orders from customers outside the assigned area;**
- **prohibition of all forms of internet selling**[5];
- **failure to provide the guarantee to customers not reached by the selective distribution network**[6].

Therefore, it is illegitimate to forbid to a reseller part of an exclusive distribution system to meet unsolicited orders from other resellers, nor – unless it is a wholesaler – to sell to final consumers (in both cases, presumably, through the Internet).

The ECJ's case-law has repeatedly stated that the clauses contained in the exclusive distribution agreements, including those relating to sales and/or exclusive purchasing and those restrictive of competition, concern " …*only contractual relations between suppliers and their approved distributors and, although they state what the parties to such agreements may or may not undertake to do in relations with third parties,* ***they do not, in contrast, serve to regulate the activities of such third parties, who may operate in the market outside the framework of distribution agreements***"[7]. Thus, for example and subject to the following: if the distributor TOM violates the ban contractually imposed by the supplier DICK to sell to the independent reseller HARRY, DICK can take legal action against TOM, but not against HARRY.

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[5] *"In the context of a selective distribution system, a contractual clause requiring sales of cosmetics … in a physical space where a qualified pharmacist must be present, resulting in a ban on the use of the internet for those sales, amounts to a restriction"* prohibited pursuant to Art. 101 TFUE *" ... if, following an individual and specific examination of the … the legal and economic context … it is apparent that, having regard to the properties of the products at issue, that clause is not objectively justified"* (ECJ decision of 13/10/2011, case C-439/09).

[6] *" ...a guarantee scheme under which a supplier of goods restricts the guarantee only to customers of its exclusive distributor places the latter and its resellers in a privileged position as against parallel importers and distributors and must therefore be regarded as having the object or effect of restricting competition..."* (ECJ case C-31/85 of 10/12/1985).

[7] ECJ decision of 15/02/1996, case C-309/94 - Nissan France SA and others; ECJ decision of 30/11/2004, case C-16/03 - Peak Holding AB.

However, always according to the ECJ's case-law, **the trademark owner can take action against third parties whose activities will result in unfair prejudice to the same owner**, as for example, using the trademark " …*in a way that may create the impression that there is a commercial connection between the other undertaking and the trademark owner, and in particular that the reseller's business is affiliated to the trademark owner's distribution network or that there is a special relationship between the two undertakings* " [8], or using the trademark for marketing or promoting the sale of products in a manner and with quality contents liable to damage the trademark's reputation [9].

Moreover, always according to Community case-law, **there is nothing** – subject to certain conditions – **that precludes the existence of an EEA State's legislation and case-law prohibiting third parties from 'damaging' an 'impervious' selective distribution network (i.e. with restrictions for those belonging to it not to sell to resellers outside it) of which they are not part, with resultant possibility for the party who created the network to also oppose parallel imports within EEA countries.** [10]

In this regard, by way of example, I remind that Art. L. 442-6, I, 6° of the French Commercial Code (Code de Commerce) contains an express ban on third parties from "*breaching a prohibition of resale outside the network to which the distributor is bound by a selective or exclusive agreement exempted from rules governing competition law* ".

On the other hand, the German case-law is unanimous in interpreting the national law on unfair competition (Art. 1 of the UWG - Gesetz gegen den unlauteren Wettbewerb) in the sense of prohibiting "... *the acquisition and sale, by persons outside a selective distribution system, of goods covered by such a system … where the system is itself legally valid and impervious both in theory and in practice… According to that case-law, a selective distribution system is thus binding on the parties and is enforceable against third parties only if it is absolutely impervious, in which case a third party who has succeeded in obtaining*

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8 ECJ decision of 23/02/1999, case C-63/97 - Bayerische Motorenwerke AG (BMW).

9 ECJ decision of 04/11/1997, case C-337/95 - Parfums Christian Dior SA.

10 ECJ decision of 05/06/1997, case C-41/96 - V.A.G. Handlerbeirat and others: "*Neither Art. 85(3) of the EC Treaty nor Commission Regulation (EEC) No 123/85 of 12 December 1984 … must be interpreted as precluding the application of national case-law on unfair competition under which a selective distribution system, even if enjoying exemption under those provisions, is not enforceable against third parties unless it is impervious*".

products covered by the system is presumed to have taken advantage of a breach of contract by an approved distributor"[11].

Parallel imports within EEA countries and trademark infringement

After this clarification, I will now examine the first element which is principally considered for the purpose of countering parallel imports within EEA countries: the trademark.
As already mentioned, within the EEA is in force the principle of the exhaustion of trademark rights, as set out in Art. 7 para. 1 of EC Directive 2008/95 "*The trademark shall not entitle the owner to prohibit its use in relation to goods which have been put on the market in the Community under that trademark by the owner or with his consent*".

To use an example, the Volkswagen Group, as said above, cannot exercise its right on its own-brand cars for opposing the parallel imports by independents Italian operators of its cars from Italy to Germany, while it could rightly oppose the imports into Germany (or Italy) of its own-brand cars from Mexico.

However, the second paragraph of the Directive (Art. 7.2) contains an important exception: "*Paragraph 1 shall not apply where there exist legitimate reasons for the owner to oppose further commercialisation of the goods, especially when the conditions of the goods are modified or altered after they have been put on the market*".

As to the above "*legitimate reasons*", the consolidated case-law of the European Court of Justice, taken up by the Member States' national courts, states that, in the case in point, the trademark owner can oppose the introduction into a Member State of products of his own brand coming from another Member State only in the presence of three concurrent conditions:

(1) the existence of a **selective distribution network**, irrespective of whether or not it operates on an exclusive licensing agreement (which I will shortly deal with), containing a related, legitimate sales ban to dealers outside the network;
(2) the marketed branded product must be **a luxury or prestige product** due to its intrinsic characteristics and/or its presentation and marketing approach to customers

[11] ECJ decision of 05/06/1997, case C-41/96 - V.A.G. Handlerbeirat e.V. , point 6 and 11.

(e.g., fashion products, cosmetics, technological products; always provided that they are high-end products followed by high quality service);

(3) **a prejudice, actual or potential**, must subsist against the product's aura of luxury or prestige as a result of its being marketed through parallel import.

In concurring these three conditions, the supplier and trademark owner DICK, pursuant to Art. 7.2 of the aforesaid Directive, can assert that the product has never been legitimately put on the market and, consequently, the trademark rights were never exhausted; he can therefore take action not only (contractually) against the dealer TOM who violated the agreement, but, on the basis of trademark protection, also directly against the third party HARRY who has purchased the products from the latter to import them into another Member State.

Parallel imports within EEA countries and unfair competition

A significant Italian juridical orientation, which too is becoming progressively consolidated, considers that *" …constitutes an act of unfair competition the conduct consisting in continuing to sell a certain brand products even after the manufacturer has made it known that there is a selective distribution system based on vertical agreements"* [12]. In fact, "*Violation of the <selective distribution system> on the basis of which the manufacturer can legitimately impose restrictions on the free movement of goods by selling its products only to selected resellers according to a combination of qualitative and quantitative criteria, with the commitment from distributors not to resell these goods to unauthorized resellers, constitutes an act of unfair competition for which applies the provisions laid down by Art. 2600 of the Italian Civil Code, under which, once ascertained the unfair competition conduct, the culpability is presumed* " [13]; such conduct "... *besides constituting a trademark infringement ... entails the assumption of unfair competition against the* ... (owner of the selective distribution network and trademark) *pursuant to Art. 2598 No. 2 and 3 of the Civil Code, as it could be argued that* ... (the parallel importer) *since not part of the selective distribution network, purchases the goods from a disloyal distribution company*..." [14].

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[12] Court of Palermo 01/03/2013 ;

[13] Court of Turin, 22/01/2006.

[14] Court of Venice, unprecedented inhibitory order of 07/07/2012.

Parallel imports within EEA countries and licensing agreement violation

Let us now examine this rather recurrent case: TOM, who manufactures and markets in Germany luxury and /or prestige products under license from DICK (the trademark owner), violates the licensing agreement requiring him not to market the licensed products in low-price retail outlets, and sells them to HARRY's bargain store of in Italy: DICK has the right to oppose the sale to HARRY, with whom he does not have a direct contractual relation. This pursuant to Art. 8.2 of Directive 2008/95/EC, which too has been implemented in Italy by Art. 5 C.P.I. (Industrial Property Code), according to which the licensor/trademark owner does not exhaust his trademark rights but he may also invoke them against third parties other than the licensee, when a licensing agreement provision concerning "*the quality of the goods manufactured or of the services provided by the licensee*" is contravened.

In conclusion: another case where it is possible to oppose the parallel import of products coming also from another EU country is when the licensee/manufacturer violates a license provision relating to marketing by altering the original quality/prestige of the products imported in parallel.

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