

## **PARALLEL IMPORTS IN MEXICO: ISSUES AND RECOMMENDATIONS**

### **Executive Summary**

Mexico currently follows the principle of *international* exhaustion with regards to parallel imports. Accordingly, importation of goods that are not authorized by the brand owner and which are not intended for the Mexican market is legal under Mexico's laws. INTA strongly supports the adoption of a national exhaustion regime, that is, a policy of not allowing unauthorized parallel imports into Mexico. We believe this is in the best interest of consumers and brand owners by eliminating the harmful effects of parallel importation, which allows for unscrupulous traders to deceive consumers with goods that are different from authorized goods and in some cases may be harmful and disrupt the established distribution channels in Mexico that assure quality and customer service.

In the absence of the complete adoption of a national exhaustions regime in Mexico, INTA recommends that the Mexican Congress considers amending the laws and/or regulations governing parallel imports to restrict such trade where the goods originate from an entity which is not owned or controlled by the trademark owner, where the goods are materially different from those traded under the same brand in the jurisdiction, or where parallel import but genuine goods are offered alongside or otherwise entwined with counterfeit goods.

The following sections provide background and conceptual definitions of what constitutes the various regimes on exhaustion of rights in relation to parallel trade. The disadvantages that parallel importation represents for the local market, trademark owners and consumers under an international exhaustion of rights policy also are discussed. Overall, the paper sets out INTA's position in favor of a national system of exhaustion of rights and demonstrates that national (or regional) exhaustion can benefit brand owners, consumers and continued investment.

### **Importance of Trademarks**

Trademarks for goods serve several functions. The primary function is to indicate the origin or source of the goods, thus enabling consumers to distinguish the goods of one trader from those of another. A trademark also serves as an indication of quality. If consumers like the goods to which the mark is applied, they will buy more. If the quality is consistent, the trademark will come to represent that quality and hence goodwill is generated, which in turn enhances the value of the trademark. A trademark thus symbolizes the goodwill which a trader has in the goods and the business supplying them. Trademark rights are historically created under national laws which establish and govern the scope of their protection in each national jurisdiction. Brand owners often design their products, packaging, sales and distribution networks to meet specific cultural, language, environmental and other conditions and requirements in specific countries. They may also authorize particular distributors in those countries, who earn royalties on sales,

often on the basis that they will provide warranties or after sales service, or local marketing or information activities. As a consequence, goodwill is built up differently in each country in which the trademark is employed. Thus, it is illogical to say that the goodwill is “exhausted” in every country once the mark has been used in just one country.

### **The Difference between Parallel Importation and Counterfeiting**

The term “parallel imports” (also referred to as “gray market goods”) refers to branded goods that are imported into a country and sold without the consent of the trademark owner, and usually without the attributes of goods meant for that country. Unlike counterfeit products, parallel imported products were once genuine products originating from the manufacture of the trademark owner. While these goods were at some point released into another country by the trademark owner, they become parallel imports when they are subsequently imported into a country for which they were not intended and this is done without the authority of the trademark owner.

### **Exhaustion of Rights in Relation to Parallel Imports**

The term “exhaustion of rights” describes the extent to which trademark owners can control the distribution of their branded goods after the first sale. There are two types of exhaustion regimes - national (or regional in the case of economic unions) and international. National exhaustion is based on the principle that, once a brand owner has sold goods in relation to which the trademark is used in a particular country, it has “exhausted” its trademark rights in relation to those goods only in that particular country. However, if the same goods are subsequently sold in another country, the brand owner can rely on its trademark rights in the other country to prevent the further sale of the goods (absent consent to such subsequent sale). In some areas of the world, particularly the European Economic Area (EEA), this concept applies regionally, that is, across a group of countries which form a single trading area. International (or global) exhaustion means that once a trademark owner has sold goods in relation to which the trademark is used anywhere in the world, it has exhausted its rights in relation to those goods everywhere in the world.

Certain countries, such as the United States, have adopted a hybrid approach, whereby parallel imports are generally permitted as long as the imported goods are not “materially different” from the manufacturer’s products distributed and sold in the U.S. The “material differences” may pertain to any characteristic of the goods, including function, composition, structure, language, taste, etc., that have a bearing on a consumer’s purchasing decision.

### **Consumer Expectations, Deception and Dissatisfaction**

Trademark owners work hard to build up an expectation of quality and value in their branded products. If these expectations are not met by parallel imported products, consumers may become significantly dissatisfied due to a number of factors, including:

- No after sales services;
- No warranty or guarantee honored;
- Incomplete or missing product information or instructions;

- Quality or formulas intended for another jurisdiction, not suitable for the consumer's purpose;
- Packaging and instructions using a foreign language;
- Inaccurate packaging claims (or omissions) as to its reusability and recyclability; and
- Omission of relevant health information (*e.g.* because it was not required in the originating country);

In addition to the risk of consumer dissatisfaction and deception, parallel imports often times do not meet the specific local requirements and safety standards for products of the type determined by national government authorities such as the Food and Drug agencies and other public health authorities. Therefore, there is a public safety risk with some parallel imports.

### **Detriment to the Economy and Consumer Protection:**

It is a common misconception that parallel imports are always cheaper for consumers than the goods sold directly by the brand owner. Research conducted in Europe (*e.g.* NERA under the auspices of the UK government) shows this to be an oversimplification:

- Parallel traders will sell the goods at the highest market prices they can command. Their aim is to maximize their profit, not altruistically benefit consumers. Studies indicate that the common decrease in price for consumers for parallel imported goods is from 0 to 2 percent. Further, parallel imported goods which may initially be marketed at a lower price are often used only as a “carrot” to attract customers initially, and prices soon rise.
- Tax variation between countries can obscure the true price differential. Legitimately traded goods are subject to payment of local taxes and duties (such as VAT or GST levied in many countries and regions including Latin America). Parallel imported goods (especially those marketed in small quantities on the Internet) may avoid the payment of such taxes. This skews the price comparison, and does not benefit the social good.
- Brand owners' pricing reflects their past and future investment. Brand owners' pricing must necessarily reflect the investment which has been made in R&D, marketing and distribution (all benefits for the consumer), not just the base price of producing the product. Parallel importers do not need to reflect such investment. They “free ride” on the brand owners' investment. Brand owners may choose –or indeed be forced- to retreat from a market if they cannot recoup the investment cost of producing their product; and/or they may be discouraged from investing in new products, to the detriment of consumers.

- Local distributors for the brand owner may also be adversely affected, having negotiated to pay a royalty to distribute the brand owners' product in a territory, and having invested in local marketing, information and provision of after-sales service or warranties, only to find competition from a parallel importer who provides none of this investment or service for consumers. Consumers may be misled into believing that the authorized distributor will honor warranties or provide after-sales services for goods with which it in fact has no sales connection.
- A low-pricing policy in a developing country, such as the supply of drugs to regions of Africa at special low prices, may be aimed at benefiting a particular disadvantaged section of society. If pharmaceutical companies repeatedly find such drugs being diverted and imported into richer countries which do not have such a significant health problem, they will be discouraged from maintaining its ethical low pricing strategy in the countries that need it.

### **Easy Road for Counterfeiters**

Studies, as well as anecdotal evidence, show parallel imported goods are often mixed or entwined with counterfeit goods. The counterfeits are "hidden" among the genuine products. Cases are not often reported, since businesses that are "caught" with counterfeit goods, when they thought they had simply imported gray goods, will generally admit liability in the face of action by brand owners and will reach a confidential settlement to avoid embarrassment. Counterfeits are a serious scourge on global trade and consumer safety and protection, and huge sums are expended by brand owners and governments to fight the problem. Anything that actively assists counterfeiting should be avoided or regulated to stop the practice.

The channels of trade for parallel imported goods are ideal for counterfeiters. By way of example, brand owners ship through regular shipping agents and ports where customs officials have knowledge of the agents and have experience with regular shipments. Both parallel importers and counterfeiters avoid such regular routes and benefit from confusion created by using multiple ports and agents.

### **INTA's Position on Parallel Imports in Mexico**

In light of the above, INTA urges that governments adopt a national exhaustion regime rather than international exhaustion of rights in order to block parallel imports, except in circumstances where the trade mark owner has positively consented to the importation of goods bearing its trademark. The burden of proof should be on the party seeking to demonstrate such consent. INTA believes that international exhaustion allows unscrupulous "grey market" traders to deceive consumers with goods that are different and in some cases may be harmful, and to disrupt the established distribution channels that assure quality and customer service.

INTA therefore recommends that Mexico's Congress consider incorporating into its laws regulations that disallow trade or importation of unauthorized parallel imports that are materially different from those traded under the same brand in the jurisdiction or trade. An inclusion of these principles and guidelines would then authorize the new Custom Recordation System for counterfeits to also be used as a notification system for parallel imports as well. This could have a positive effect on Mexico's overall efforts to strengthen its protection of consumers and trademark rights.