



International Trademark Association

655 Third Avenue, 10th Floor, New York, NY 10017-5617 USA

+1-212-768-9887 • f: +1-212-768-7796 • www.inta.org • info@inta.org

International Trademark Association

Position Paper

on

Parallel Imports

July 2007

Table of Contents

	<u>Page</u>
Defining Terms	1
<i>“Parallel Imports” or “Gray Market” Goods</i>	
<i>National (or Regional) Exhaustion of Rights</i>	
<i>International (or Global) Exhaustion of Rights</i>	
<i>“Hybrid” Approaches</i>	
Background	3
Research	4
The Current Position Worldwide	4
INTA’s Position	5
Support for INTA’s Position	6
1. <i>Consumer benefits in brands are undermined by parallel trade</i>	
2. <i>Brand owners’ investment in brands is threatened</i>	
3. <i>The economic analysis favors national (or regional) exhaustion</i>	
4. <i>Packaging, quality, suitability and environmental issues</i>	
5. <i>Consumer unhappiness/dissatisfaction</i>	
6. <i>An easy road for counterfeiters</i>	
7. <i>To thrive for the good of all, global trade must be encouraged and nurtured with appropriate regulation</i>	
Burden of Proof	12
Conclusion	13

Position Paper

International Trademark Association

Parallel Imports

Defining Terms

“Parallel Imports” or “Gray Market” Goods

The terms “parallel imports” and “gray market” goods refer to branded goods that are imported into a market and sold there without the consent of the owner of the trademark in that market. The goods are “genuine” goods (as distinct from counterfeit goods), in that they have been manufactured by or for or under license from the brand owner. However, they may have been formulated or packaged for a particular jurisdiction, and then are imported into a different jurisdiction from that intended by the brand owner.

The debate over parallel importation focuses on the extent to which a trademark owner should be able to maintain control over its own brands by using its trademark rights in a country (or a region) to restrict the importation of goods into that country (or region) after the goods have been put on the market somewhere else by the trademark owner, or with its consent, or by another person (whether or not related to the owner) who owns rights in the jurisdiction where the goods originated.

National (or Regional) Exhaustion of Rights

“National exhaustion” is the principle that, once a brand owner has sold goods in relation to which the trademark is used in a particular country, it has only “exhausted” its trademark rights in relation to those goods in that particular country. If the same goods are subsequently sold in another country, the brand owner can rely on its trademark rights in that 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 part of a single trading area. It also covers the situation

where trademark rights can be acquired in a part of a country or territory, for example, a U.S. state registration or a single country registration in the European Union, and where trademark rights can also be acquired at a regional level, for example, a U.S. federal trademark registration or a European Community trade mark.

International (or Global) Exhaustion of Rights

“International exhaustion” is the principle that, once a brand owner has sold goods in relation to which the trademark is used somewhere in the world, it has exhausted its trademark rights in relation to those goods everywhere in the world.

“Hybrid” Approaches

These two general approaches may be modified by the addition of other rules or restrictions. For example, the United States nominally applies the principle of international exhaustion, but goods may only be allowed for importation if they come from a company which is affiliated with the brand owner, and they are not materially different from those marketed in the United States. In the United States, the brand owner is able to stop imports if they differ materially in relation to, for example, formulation, fragrance, color, calories, lot code removal, size, fill volume, packaging, language, guarantees, labeling and instructions. The same could be said for Canada, but the standard of materiality of physical and other differences is much higher than in the United States: typically, only those physical and other differences that are likely to cause harm to consumers or the public good are sufficient to enable the brand owner to object to parallel importation.

Within the EU, material differences may be sufficient to enable a brand owner to prohibit the movement of goods *between* member states, provided that such differences have not been introduced specifically so as to carve up the market; but it is not necessary for a brand owner to show the presence of material differences in order to prevent the entry of branded goods into the EU from elsewhere in the world. Subject to the issue of consent (discussed below), a strict rule of territorial exhaustion is applied.

Background

The primary functions of a trademark for goods may be characterized in more than one way. The first and foremost function is to indicate the trade origin or source of the goods in relation to which it is used, thus enabling consumers to distinguish the goods of one trader from those of others. A trademark also serves to guarantee 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 respective national jurisdiction. Brand owners often design their products, packaging, sales and distribution networks to meet specific cultural, language, environmental and other conditions in specific countries. They may also authorize particular distributors in those countries, who earn royalties on the sales, often on the basis that they will provide warranties or after sales service, or local marketing or information activities.

From this it may be seen that goodwill is built up differently in each country in which the trademark is used. Thus, it is inherently illogical to say that the goodwill is “exhausted” in every country once the mark has been used in just one country.

Parallel importers generally acquire genuine goods in one jurisdiction, and then import them into another jurisdiction, undercutting in price the trademark owner or authorized distributor. They may be able to undercut price for various reasons, including having acquired the product from a jurisdiction where it is sold at a lower price (usually because of differing local economics and sometimes also because of a differing quality); or because they do not invest in product research and development or the provision of warranties, guarantees, after sales service, promotion, marketing and information distribution, and/or do not need to support distribution networks.

The activities of parallel importers do not just affect the brand owner's sales figures; they undermine consumer trust in brands and the quality and service they represent, or in other words they diminish the goodwill and harm the trademark

Research

In reaching the position set out in this paper, the 2006–2007 Parallel Imports Committee has considered the contents of a number of reports and studies in relation to parallel imports and trademark exhaustion, including those listed below:

- § NERA Report for the EU Commission: “The Economic Consequences of the Choice of a Regime of Exhaustion in the Area of Trademarks,” February 1999
- § AIM Position Paper: “Parallel Trade—Consumer Benefit or Consumer Loss?” April 1999
- § Max Planck Institute: “Parallel Imports and International Trade,” June 1999
- § European Commission: “Exhaustion of Trade Mark Rights—Working Document from the Commission Services,” December 1999
- § International Chamber of Commerce: “Exhaustion of Intellectual Property Rights,” January 2000
- § AIPPI Q.156: “International Exhaustion of Industrial Property Rights,” March 2001
- § OECD Joint Group on Trade and Competition: “Synthesis Report on Parallel Imports,” June 2002
- § London School of Economics Special Research Paper: “The Economic Impact of Pharmaceutical Parallel Trade,” January 2004
- § Imperial College London, funded by the Economic and Social Research Council: “Intellectual Property Rights: Trading in Pharmaceuticals,” March 2004
- § National and Regional Reports by the subcommittees of the INTA Parallel Imports Committee for the 2004–2005 term

The Current Position Worldwide

There is currently no international treaty or consensus dictating a standard of national (or regional) exhaustion, or international exhaustion. The Paris Convention does not

address the issue. The agreement on Trade Related Aspects of Intellectual Property (TRIPs) is deliberately neutral on the subject. Article 6 of TRIPs reads:

“For the purposes of dispute settlement under this Agreement ... nothing in this Agreement may be used to address the issue of the exhaustion of intellectual property rights.”

Research by INTA’s Parallel Imports Committee found that, currently, the concept of national (or regional) exhaustion dominates throughout the world. A review of the laws of many countries throughout the world in 2004–2005 found that a significant majority favored national or regional exhaustion.

The EU comprises the most significant block of countries in the world where an established system of regional exhaustion applies. Because a number of its 27 member states are also among the wealthiest in the world, and have relatively high price structures for consumer and healthcare goods, the EU is a particularly attractive target for parallel importers.

INTA’s Position

- § INTA disapproves of parallel imports, except between countries that are in recognized regions with truly harmonized markets.
- § INTA approves of national exhaustion or, in appropriate cases, regional exhaustion of rights.
- § INTA disapproves of international (or global) exhaustion of rights, except in circumstances where the trademark owner has positively consented to the importation of goods bearing its trade marks. Such consent will usually be express, but may be implied from circumstances that unequivocally demonstrate that the trademark owner has renounced any intention to enforce its rights.
- § INTA advocates that, in disputes concerning parallel imports, it should be for the parallel importer or subsequent trader alleging consent to prove it and not for the trademark owner to demonstrate its absence.

INTA believes that this position is in the best interests of brand owners and their customers (the consumers) and of orderly markets. INTA considers that international exhaustion allows unscrupulous “gray-market” traders to ride on the back of investment in markets by genuine trademark owners, with little benefit and significant possible detriment to consumers. INTA believes that national (or regional) exhaustion of rights provides the most benefit to consumers and encourages thriving trade.

In order to ensure orderly markets and consumer protection, INTA encourages governments whose legal systems follow an international exhaustion policy to change their laws so as to adopt national or appropriate regional exhaustion.

If local conditions prevent the possibility of making such a fundamental change, INTA recommends that governments incorporate in their laws on parallel imports at least the following strategies, applying to all gray marketers:

- § disallowing trade where the goods originate from an entity which is not owned or controlled by the trademark owner;
- § disallowing trade where the goods are materially different from those traded under the same brand in the jurisdiction: material differences may include formulation, fragrance, color, calories, lot code removal, size, fill-volume, packaging, language, guarantees, labeling and instructions; and
- § disallowing trade where genuine goods are offered alongside or otherwise entwined with counterfeit goods.

Support for the foregoing stance can be found in consumer benefit legislation adopted by South Africa in 2007.

Support for INTA’s Position

1. Consumer benefits in brands are undermined by parallel trade

Brands provide a number of important benefits for consumers in a healthy and vigorous trade environment. The brand is the “face” of a product, recognizable by consumers and indicating qualities they have come to expect and trust. Brand owners therefore have a high stake in ensuring that their brands are associated with high quality and a good buying experience, that is, in protecting the goodwill associated

with the brand. Brand owners invest in their brands, and the protection of their brands, in order to ensure this.

Benefits to consumers in this scenario include:

- § **reassurance** that the branded product is reliable, of a certain quality;
- § receiving the expected quality and **satisfaction** from the purchase;
- § **confidence** that the branded product is the same as that purchased previously and is equally **suitable for their needs**;
- § **trust** in the quality or value which the brand signifies to them;
- § in many cases, **convenience** of wide availability; and
- § **expectation** that the branded product will be backed by the brand owner with quality guarantees or after sales service.

Parallel traders who do not deliver these consumer benefits both undermine the value of the brand to the brand owner, and deceive or disappoint the consumer.

2. *Brand owners' investment in brands is threatened*

Brand owners invest in the promotion, development and protection of their brands in order to attract consumers with the benefits described above. In the same way, they invest in R&D and maintenance of quality on their products which are marketed under the brand.

When brand owners have built, with this investment, a valuable brand with good consumer association, they are encouraged to expand into new markets which may not otherwise be serviced, including R&D into the best product formulations or specifications for the new market. Brand extension into new products also receives investment, to the benefit of consumers.

If the return on this investment is undermined by parallel imports, the investment will inevitably fall away, leaving:

- § less choice and availability for consumers;
- § less R&D for new products and a consequential slowdown in innovation;
- § less expansion into new geographic markets (especially those where global exhaustion prevails); and

§ less trade and its associated benefits.

3. *The economic analysis favors national (or regional) exhaustion*

It is a common misconception that parallel imports are always cheaper for consumers than the goods marketed directly by the brand owner, but research shows this to be an oversimplification. (Information sourced from the reports listed in the Research section, particularly the AIM Position Paper and NERA Report.)

- A. 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.
- B. Tax variations 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, Europe and Australia). 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 is not to the social good.
- C. 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.
- D. 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 if 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.

- E. 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.

4. *Packaging, quality, suitability and environmental issues*

Parallel importers often alter the packaging of goods, or import and sell goods intended for another market which uses different packaging. They may also remove lot numbers (which allow goods to be traced more easily in the case of product recall, for example); or over-stick information as to origin, ingredients or other mandated information. This often leads to breaches of packaging legislation, which in turn places consumers at risk.

The quality of product frequently varies from region to region. Not all formulations suit all markets; and in addition delays in delivery of parallel imported goods (old stock, or long and inefficient distribution channels) can erode the quality of the original product. Again, this is to the detriment of the consumer and erodes the brand owner's value in the brand.

Some examples:

- § Lack of regulatory or marketing approval for sale of the relevant product in the import country, for example, sanitary regulations in South America.
- § Unworkable consumer helpline or consumer careline phone number(s) in the import country.
- § Fundamental formulation or recipe variations according to consumer or cultural tastes, for example, abrasives in toothpaste—silica, calcium carbonate or bicarbonate of soda—which are very regionally specific and don't sell well or at all “out of region”, thereby damaging brand confidence; another example

is bromide in bread, which is permitted in some countries but not in others (for example, Peru).

- § The same risk could be applied to any food products under international brands where the recipes used will always vary according to local culinary norms.
- § The taste of many products can vary depending upon the market for which they are intended—for example, top selling European brands of toothpaste in Indonesia taste of cloves, not mint. Brand owners research local flavor preferences and tailor their product accordingly.
- § Face cream formulated for the humidity of the tropics is inappropriate for the northern European consumer.
- § A DVD player purchased in the United States will not play all DVDs sold in the United Kingdom or Australia.
- § Motor lubrication oils are radically different for the Middle East and Scandinavia.
- § Excessive heat while shipping can ruin the taste and fizz of soft drinks.
- § A leading brand of cigarettes which reaches the EU by parallel routes may deliver a tar yield (15 milligrams) in excess of the limit authorized in the EU (12 milligrams) while misleading consumers by indicating a lower tar yield on a paper label stuck to the packs by the parallel trader.
- § Parallel imported products may enter a country from a jurisdiction with different environmental protection laws or packaging waste laws, that do not meet the needs of the country of import.
- § Personal care or cleaning products sold for use in some countries are formulated to meet hard water conditions which do not exist in other countries.

5. *Consumer unhappiness/dissatisfaction*

As noted, brand 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 be significantly dissatisfied, for example with:

- § no after sales service;
- § no warranty or guarantee honored;
- § incomplete or missing product information or instructions;
- § quality or formulation intended for another jurisdiction, not suitable for the consumer's purpose;

- § package uses a foreign language;
- § packaging makes (or omits) claims as to reusability, recyclability and the like which are inaccurate;
- § information relevant to diabetes or allergy sufferers or other relevant health information may be omitted (e.g. because it was not required in the originating country);
- § levels of tar or nicotine in tobacco products or alcohol in beverages may exceed local mandates, endangering consumer health;
- § pharmaceuticals which are parallel imported may not comply with local mandates and may endanger consumer health;
- § cases have arisen where the packaging of pet medicine bears incorrect directions for the climatic conditions in the country of import.

If medicine or beverages do not meet local governmental requirements, emergency telephone numbers on the packaging for medicine are missing or inaccurate, directions are inapplicable or the product is stale or otherwise rendered ineffective, potentially serious consequences may follow. If consumers use these products, they run the risk of not only being simply dissatisfied but also their health, and in some cases the health of their pets, may be put at risk.

6. An 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” using counterfeit goods, when they thought they had simply got a good deal on some 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 this practice.

The channels of trade for parallel imported goods are ideal for counterfeiters. 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 different ports and agents.

7. *To thrive for the good of all, global trade must be encouraged and nurtured with appropriate regulation*

Global exhaustion—where goods travel freely everywhere—is an idealistic goal which may be possible (indeed even preferred) if and when the world has:

- § a global single market;
- § global market access for all;
- § global consumer protection;
- § global social protection;
- § global environmental protection; and
- § global enforcement of IP rights.

Until then, the unregulated adoption of the global exhaustion principle allows unscrupulous parallel importers to thrive, puts consumers at risk and discourages trade.

Burden of Proof

In order for a parallel importer to defend an allegation of trademark infringement by a brand owner, it has to be proven that the trademark owner consented to the importation of the branded goods. This raises two potentially contentious legal and procedural issues:

1. Which party has the burden of proving this; and
2. What constitutes “consent?”

INTA favors the view that the parallel importer, who is alleging “consent” in his defense, should bear the burden of proving this. Moreover, the parallel importer must establish that the consent was clear and unequivocal. This is the position that has been

reached in the EU after considerable legal debate and judicial analysis, and it also accords with the position in many countries whereby the grant of a license by the owner of an intellectual property right is to be interpreted restrictively, in favor of the right owner.

It is the view of INTA that it is manifestly unreasonable to create a presumption that a trademark owner has consented to parallel importation of its goods or to rely on national contractual or other doctrines of implied or indirect consent. It is more reasonable to create a presumption that a trade mark owner has not consented. This presumption could be open to rebuttal by the importer proving either that the trademark owner has expressly approved the importation in question or that there are circumstances which unequivocally demonstrate that the trademark owner has renounced any intention to enforce its trademarks. Such a rule is more in line with the realities of the marketplace, and takes into account the possible differences in quality and image that commonly exist between goods designated for different markets.

If a trademark owner is considered to have given consent, and thereby to exhaust its trademark rights which would otherwise be available, then such consent should, logically and fairly, be shown unequivocally, and not merely implied.

Conclusion

There is currently no international treaty or consensus dictating a standard of national (or regional) exhaustion or international exhaustion. Most countries of the world appear to favor national (or regional) exhaustion. For the reasons discussed herein, INTA approves of national (or regional) exhaustion, which provides protection for the investments made by brand owners in their brands, and provides the most benefits for consumers.

INTA recognizes that there is amongst the public generally, and in some governments and legislatures, an increasingly negative attitude towards the concept of national (or regional) exhaustion, in the largely mistaken belief that parallel imports are of significant benefit to consumers. In its comments on this matter, INTA hopes to dispel this misconception and point out that national (or regional) exhaustion can benefit

brand owners, consumers and continued investment in all countries both developed and developing, as well as orderly global trade.
