A “Material Differences” Standard for International Exhaustion of Trademark Rights

May 2, 2015

Sponsoring Committee: Parallel Imports Committee

Resolution

WHEREAS, trademark owners often design their products, packaging and sales and distribution networks to meet specific cultural, environmental and other conditions in specific countries;

WHEREAS, consumers expect that products will be appropriately formulated for their geographic regions;

WHEREAS, the value of a trademark depends in large part on the goodwill generated by providing the consumer with a consistent level of quality and service and a product with features that meet the consumer’s expectations based on the consumer’s past experience with the product bearing the trademark; and

WHEREAS, the value of a trademark can therefore be undermined and consumers’ expectations can be frustrated if a standard of international exhaustion of trademark rights and free parallel importation is followed;

BE IT RESOLVED, that it is the position of the International Trademark Association that:

1. National exhaustion of trademark rights in relation to the parallel importation of goods should be applied; and
2. In those countries that currently follow international exhaustion, and in which political or other conditions make it highly improbable that national exhaustion would be implemented, a “material differences” standard should be adopted in order to exclude parallel imports that are materially different from those products authorized for sale by the trademark owner in the domestic market.

Background

The debate over parallel importation focuses on the extent to which a trademark owner should be allowed to maintain control over its own brands by using its trademark rights in a country (or group of countries as we have defined “national”)[1] to restrict the importation of goods into that

country after the goods have been put on the market somewhere else by the trademark owner or with its consent.

No International Consensus on Exhaustion of Rights

INTA has developed its position on parallel imports over several decades. The most recent Board resolution, adopted May 26, 1999, calls for strict adherence to the principle of national exhaustion. The 1999 Resolution does not allow for any middle ground approaches, such as a "material differences" standard, for those countries that are unwilling to move from international to national exhaustion.

INTA believes that national exhaustion is the best way to protect trademark owners and consumers. A standard of national exhaustion appropriately takes into account many brand protection concerns that are not addressed under a standard of international exhaustion. The prices at which products are sold can vary from country to country for a great variety of legitimate reasons, among them differences in regulatory requirements, environmental standards, labor and material costs, and government subsidies and taxes. Parallel importers exploit these conditions by buying products in a market where they are relatively less expensive and selling them in another market where prices are higher typically due to local product differences, contractual necessities, local labor costs, or regulatory requirements. They argue that parallel trade enhances competition and benefits consumers by providing for a larger distribution of branded products at lower prices, although studies have consistently shown that the financial benefit to the consumer is minimal (it is the parallel importers who benefit financially). Moreover, parallel importers have little or no incentive to maintain the goodwill of the mark and its ability to attract customers in the future. The parallel importer spends less time and effort to ensure the quality of the product and may provide little, if any, warranty or service. Many parallel imports are of 'old' stock (often nearing the sell-by date) and for some products (e.g., perishable or medical) there is no certainty that they have been kept or transported in appropriate conditions. Consumers are entitled to expect the products to be in the correct condition.

Further, given the wide diversity of personal preferences among consumers and of environmental standards and conditions in unrelated cultures and economies, products with the same trademark often vary when produced for sale in different markets. For example, 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. A brand of toothpaste in one country may taste different from the same brand sold in another country because the brand owner has researched local flavor preferences and tailored the product accordingly. Ingredients in motor oils need to be adjusted according to the climate in which they are intended to be sold.

Price alone is not a consumer's only concern when buying a product. The consumer relies on the trademark to identify specific goods or services that will meet certain expectations about the quality and characteristics of the product and the level of after-sales service. If these expectations are not met because a consumer receives a product intended for sale in another market, even if he or she has not been deceived in any way about the product, the consumer will be disappointed and will usually blame the trademark owner. Thus the trademark owner's reputation is damaged, the brand value diminished and the consumer may even be harmed.

The Need for a "Material Differences" Standard

Despite the clear advantages of national exhaustion, it must be recognized that political or other considerations may make it infeasible for some countries to move from international to national exhaustion. In these circumstances, at the very least, it is critical for those countries to provide for the exclusion of parallel imports that are materially different from those products authorized for sale by the trademark owner in the domestic market.

The "material differences" standard is well developed in the United States courts. For example, in the leading case of *Societe des Produits Nestle*,[2] chocolates manufactured for the Venezuelan market were excluded from the United States due to differences in ingredients, differences in the configuration and variety of shapes included in the collections, differences in the color and gloss of the packaging, differences in the language on the packaging, and differences in the quality control procedures governing the temperature at which the chocolates were transported. Other material differences recognized by United States courts include scratched off serial numbers, dosage information in an unfamiliar unit of measurement, lack of a valid warranty, and failure to comply with food labeling regulations. Materiality should not be determined solely according to objective criteria (in particular non-compliance with product safety laws, labeling regulations and other national laws), but also from a consumer's perspective. Anything that could affect the consumer's willingness to purchase a product, or that could create consumer dissatisfaction after the purchase, should be considered material.

Material differences do not need to be physical in nature, as many non-physical differences (such as the absence of product support, warranty, or instructions in the consumer's native language) may be material to the consumer. Nor do the differences in question must be so extreme as to threaten the health or safety of the consumer, as the consumer's legitimate expectations may be defeated regardless of the risk of physical harm.

Conclusion

Based upon its analysis and deliberations, the Parallel Imports Committee recommends that the Board reaffirm its commitment to national exhaustion in all cases. The Committee further recommends that the Board recognize that, for those countries in which it is not feasible to move from international to national exhaustion, at the very least those countries should allow for the exclusion of parallel imports that are materially different from those products authorized for sale by the trademark owner in the domestic market.

[1] "National" in this Resolution refers to an independent country or group of countries which have adopted a single, common market with an overriding governmental authority, which operates rules and regulations in the field of intellectual property for the common market, and which operates a court system which has the ultimate authority on the interpretation and enforcement of those rules and regulations. The European Community (or by special treaty the European Economic Area) is an example of a single market. Treaties ruling free trade in a given area may not fall under this definition.

[2] *Societe des Produits Nestle, S.A. v. Casa Helvetia, Inc.,* 982 F.2d 633 (1st Cir. 1992).