Competition Law

Parallel imports – another view

by Tony Willoughby

Tony Willoughby

In the High Court in London recently, Mr Justice Laddie handed down his decision in the *Davidoff* case (unreported). It was an application by the plaintiff, Davidoff, for summary judgment against the defendant, a parallel trader, to restrain him from importing Davidoff branded product into the European Union. The goods are available in Singapore at very low prices and the importer is now undercutting Davidoff's UK price, bypassing Davidoff's distribution network and in the process damaging the market for the brand. The judge refused the application and allowed the defendant to continue his defence of the action.

To say that the judge was disenchanted with the plaintiff's arguments would be an understatement. The judge was clearly outraged. Why? It was a trademark infringement action. The purpose of a trademark is to indicate the trade origin of the goods on which it appears and most trademark infringement actions concern trademark uses, which are (or are argued to be) likely to deceive consumers as to the true origin of the relevant products. In the case of parallel imports the goods are genuine goods of the trademark proprietor. The trademark on the goods in question is doing no more than performing its proper function – i.e. accurately identifying the trademark owner as the trade source of the goods.

How could that sensibly be construed as trademark infringement? The argument is possible for no reason other than that trademark rights are both exclusive and territorial. Registration of a trademark at the Patent Office gives to the proprietor the *exclusive* right to the use of the trademark in relation to the goods for which it is registered *in the UK*. Importation into the UK without the trademark owner's consent of goods within the protected category (even genuine goods manufactured by the trademark proprietor) on its face invades the proprietor's exclusive right.

While it may at first sight appear absurd that the use of a trademark accurately performing its function can constitute trademark infringement, it is nonetheless the fact that trademark law (*Trade Marks Act* 1994) is littered with other similar anomalies. Section 10(1) catches (in addition to parallel imports) third party uses of the identical mark, which are not likely to cause deception as to trade origin. Section 10(3) permits a finding of infringement where there is no likelihood of deception, but where the trademark is in some way denigrated. Section 10(6) allows for infringement where the trademark is accurately performing its function as an indication of origin, but the use is in some way dishonest (e.g. in some forms of comparative advertising).

The common thread is that all these types of infringement interfere with the trademark proprietor's quiet enjoyment of his exclusive right. They all damage the brand, notwithstanding that there may be no likelihood of deception as to trade origin. Similarly, most parallel imports (certainly those in the field of luxury goods) damage the brand involved. Since brands are trademarks and trademark law is the only readily available body of law dealing with a brand owner's rights in relation to his brand, it may be that trademark law is the appropriate mechanism for regulating parallel imports. If trademark law is not to provide the regulatory mechanism, some other mechanism must be found, for parallel imports are bad not only for the brand owner but also, in the long term, for the consumer.

WHY ARE THEY A BAD THING?

The implications vary to some extent depending on the category of product involved – the necessities of life at one end of the spectrum and the luxuries of life at the other. Another variable is the conduct of the trademark owner, whose behaviour in the matter may or may not have been impeccable.

The two categories of product most susceptible to parallel trade are pharmaceuticals and luxury goods, the reason being that for different reasons brands in those categories are likely to be found at widely differing prices in different parts of the world. Pharmaceuticals are a special case because the reason for the price differential is usually local governmental price controls. Accordingly, for the purposes of this commentary, luxury goods will be the main focal point.

Irresponsible brand owners lay themselves open to the attentions of parallel traders by failing to take basic precautionary steps such as rationalising prices where it is possible to do so, by allowing oversupply to particular markets and by failing adequately to regulate (contractually) and supervise licensees and distributors. They deserve little sympathy and for the purposes of this commentary they can be ignored. Suffice it to say that trademark law is well adapted to dealing with their like by providing that they have effectively 'consented' to the natural and probable consequences of their failings.

So we are left with the luxury brands of responsible brand owners. A luxury product is a product which is not a necessity of life, but which is expensive and is held out to improve one's well-being and/or status and/or quality of life. It is more expensive than other products because it is more expensive to manufacture or simply because the

demand enables the brand owner to charge an inflated price for the product or for both of those reasons. Additionally, as will be seen below, the luxury product is more expensive to market.

For some people luxury items are a treat and for others they are simply the trappings of wealth. It is their rarity value that makes them a treat. Less attractively, but realistically, for some they may be status symbols and for that purpose too their being out of the reach of the masses is a *sine qua non*. A fundamental point to bear in mind when it comes to addressing whether or not parallel imports are socially desirable is that nobody *needs* luxury items. The desire for the brand is not controlled by a need. It is solely the creation of the brand owner.

The brand owner's ability to charge a high price is dependent upon creating and maintaining a demand for the brand. This may be down to the inherent quality of the product or the perceived quality of the product. In both cases carefully planned and suitably 'luxurious' advertising and promotion is vital. It is also very important that the manner of presentation of the product at retail level is consistent with the image created by the advertising. Accordingly, most luxury brands are sold through carefully selected retail outlets. They are often small 'exclusive' establishments in expensive parts of town and with highly trained staff. Their overheads are high and they need to be able to incorporate a substantial mark-up to cover those overheads.

How is it that the brand is available elsewhere at substantially lower prices? The reasons could include any one or more of the following:

- the cost of manufacture and/or marketing varies from country to country;
- the purchasing power of consumers varies from country to country;
- the 'positioning' of the brand varies from country to country;
- the stock in question is stolen or is bankrupt stock obtained from a liquidator or is stock which has been offloaded for some reason by somebody in the supply chain at knock-down prices.

Many of these differing circumstances vary from time to time as well as from place to place. A brand owner who thinks that he has at last got his house in order may suddenly find himself in trouble again as a result of a change of government somewhere or a currency fluctuation.

BRAND OWNER SELF-HELP

However, let us ignore the possibility (and reality) of shifting market conditions and concentrate on the first three of those bullet points, which may appear, to a degree, to be within the control of the brand owner.

Varying costs of manufacture

We are told that 75% of LEVI'S jeans sold in this country are manufactured in Scotland and that the cost of manufacture there is very significantly higher than in some other countries, including the US. Should the responsible brand owner, concerned about the effect of parallel imports into the UK, close the UK factory and import from the US? Would that be in the public interest? The answer may depend on the section of the public whose views are sought. The factory employees are unlikely to be very happy about it.

Varying purchasing power of consumers

Here a brand owner is damned if he does and damned if he does not. If he seeks to exploit the local market at prices affordable to the local consumer, and if Mr Justice Laddie has his way, he exposes himself to the risk of those goods coming back into the UK and undermining his brand positioning here. If he does not exploit the brand in the local market, he exposes himself to the risk of a local entrepreneur adopting his brand name locally. Anyone familiar with the problems faced by brand owners in Indonesia will readily understand. Even here in the UK, non-use is a ground for invalidation of a trademark and opens the door to other would-be registrants.

Brand differently 'positioned' elsewhere

It is well established under our own law of passing off that goodwill is local and divisible. It reflects the reality that, for any one of a dozen or more reasons, a brand may be differently perceived by different groups of purchasers in different parts of the world. The goodwill associated with the brand in the UK may be wholly different in nature from the goodwill associated with the brand in Japan, for example. Compare the differing 'positions' of STELLA ARTOIS – a mainstream brand in its home country (Belgium) – and a premium brand here. Compelling brand owners to adopt identical 'positioning' everywhere is simply not sensible. It may be possible with some brands, but not all. And why should it be necessary? Indeed, the 'positioning' of products may vary from time to time as well as from country to country. It was not long ago that LUCOZADE was seen as a drink for invalids; it is now regarded as a sports drink.

Some suggest that the brand owner can solve the problem by adopting different brand names for the product. Colgate-Palmolive could call its dental cream COLGATE in high-priced countries and BRAND X in low-priced countries. The suggestion is ludicrous. Even if one were to ignore the risks of dropping the name COLGATE in the low-priced countries, imagine what would happen in the high-priced countries. The 'parallelers' would bring in BRAND X, advertise and promote it as being identical in all respects to the product sold under the name COLGATE, and there would be nothing that the brand owner would be able to do about it.

Another popular suggestion is that the brand owner should shroud supplies to the low-priced markets with territorial restrictions on onward dealings. In third world countries desperate for hard currencies the imposition of re-export restrictions is often illegal. In other countries such restrictions may be banned for being unduly restrictive and anti-competitive. In countries such as the UK the restrictions may not be enforceable against the importer/distributor unless all in the supply chain have had the restrictions brought home to them.

Identifying the links in the supply chain may prove a problem. Brand owners who code their supplies may be able to do so, but Mr Justice Laddie has thrown a spanner in the works there too. In *Davidoff* he has held that there is nothing objectionable in principle for parallelers to obstruct brand owners by defacing the codes.

WHERE DOES THE PUBLIC INTEREST LIE?

Who benefits from parallel trading? First and foremost there are those few individuals who travel the world looking for business opportunities. They look for consignments of desirable stock and follow the currency fluctuations which throw up some of those opportunities. Secondly, there are their main customers, the supermarkets and the major cash and carry companies, who directly or indirectly provide the stock to the consumers. Finally, there are the consumers who are able from time to time to acquire the branded stock at lower than usual prices.

Who suffers? Well, first, there is the brand owner whose carefully-planned advertising and promotion campaign is undermined; then there are the employees in the factories that may have to be closed; there are the official distributors and specially selected retailers whose businesses will be adversely affected and there are the consumers who paid for what they believed to be exclusivity. In addition there are the consumers in the country of intended sale who have been deprived of the supplies.

Is the benefit to the UK consumer worth it? Does it really matter if they are deprived of the opportunity to save a few pounds on a particular branded product? After all, the products in question are not the necessities of life. Other brands of the same type of product are available. Moreover the benefits of lower price will only survive for the life of the consignment in hand. It is very rare that a paralleler is able to lay his hands on continuous supplies of any one brand.

CONSEQUENCES

If parallel trade is to become the accepted norm, there will be three major changes to the UK marketplace.

(1) Some of the hitherto exclusive brands will become commonplace and lose their *raison d'être*. Why would a brand owner spend money promoting a brand at a carefully-positioned level in the market, knowing that at any moment that position could be undermined by a supermarket? Many brands will disappear.

(2) Many of the smaller specialist retailers will also disappear from the scene. They rely for their existence on the demand for their products at relatively high prices. The availability of their products in supermarkets at lower prices will destroy their viability. The profile of the High Street will change, at any rate in relation to the retail sale of international brands of luxury products.

(3) Counterfeiting will become much more of a problem in the UK than it is at present. Parallels and counterfeits are common bedfellows. The conditions that attract parallelers (namely high demand and price differentials) also attract counterfeiters. Parallelers are known to have turned to counterfeiting when their stocks of parallel product have dried up. Where there are parallels in the marketplace there are variably-priced genuine products passing down unofficial supply chains – ideal circumstances in which to slip in and 'lose' counterfeit product.

In social terms the counterfeiting of luxury goods might not be regarded as a major threat to our lifestyle, but that is not where the real trouble will lie. A third-world problem from which we are largely insulated is the counterfeiting of pharmaceuticals – placebos masquerading as antibiotics and cattle blood masquerading as Aids-tested human blood. The opening up of EU borders – and therefore UK borders – to parallels from Africa, India and the Far East will bring in all manner of packs of pharmaceuticals in all manner of languages and with all manner of over-stickers. Sorting out the genuine from the counterfeit will be a horrendous task.

CONCLUSION

In his judgment in *Davidoff*, Mr Justice Laddie states that, in his view, the right (if there be such a right) for a brand owner to restrain parallel imports is 'a parasitic right to interfere with the distribution of goods which bears little or no relationship to the proper function of the trademark right.' The use of the word 'parasitic' in that context is unfortunate. The Trade Marks Act provides for many forms of infringement, which have no bearing on a trademark as an indication of origin. If there is a parasite, it is the parallel importer. The brand is his lifeblood. He renders it no service whatever. Indeed, he sucks it dry before moving on to the next one.

Essentially the issue is encapsulated in these competing statements:

'Brand owners tend to think that because they own the brand, the brand is theirs to do what they want with it.' (Marketing Week, 29 October 1998)

'Since goodwill is a territorial concept ... a manufacturer ought to be free to decide for himself by what goods he will make (or break) his reputation in that territory.' (Lord Justice Lloyd in *Colgate v Markwell Finance Ltd* [1989] RPC 531)

The author of the former is clearly of the view that, once a brand owner has created a public demand for his brand, the brand becomes a piece of public property.

The latter quote was from a case involving different qualities of product. However, Lord Justice Lloyd's decision on the trademark issue did not turn on the difference in quality, and the quote is equally applicable to the 'positioning' of goods in the marketplace. In other words, if a brand owner chooses to position his brand at a particular price level and aim at a particular clientele, he should be entitled to protect that position.

Since both brand owners and consumers depend, in the long term, on the survival of the brand as a desirable commodity, any perceived short-term conflict of interest should be resolved in favour of the entity most likely to nurture and protect the brand, namely the brand owner. If this means that parallel traders are then restricted to trading in brands whose owners have relinquished their responsibilities to the brand, so be it.

The contrary view involves treating the world as a global market, a vision which is inconsistent with the territoriality of trademark rights, inconsistent with our common law as to the local and divisible nature of goodwill and inconsistent with commercial reality.

Tony Willoughby
Senior Partner, Willoughby & Partner