

Exhaustion of Trade Mark Rights

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Background

Exhaustion and parallel trade

Historically certain countries have chosen to follow the concept of global exhaustion whereby a company marketing a product in one country under a chosen trademark cannot object on the grounds of trademark infringement to subsequent sales of that product in any other country where the company owns the trademark rights. The trademark owner is deemed to have *exhausted the right* at the first point where the owner markets the goods. Global exhaustion enables parallel trade.

The position in Europe

Within the EU the concept of exhaustion of rights is integral to the doctrine of free movement of goods but is limited under article 7 of the 1989 Trademark Directive 89/104/EEC to EU-wide exhaustion so that the EU can operate as a single trading community. This *concept of regional exhaustion* was extended, under an EU agreement with certain EFTA countries, to Iceland, Norway, Switzerland and Liechtenstein.

The concept of EU-wide exhaustion applies to all intellectual property rights which have been harmonised at EU level. This applies not just to trademarks but in areas such as patents and authors' rights. Global exhaustion would be a fundamental change in European intellectual property law. At the international level, there are no agreements on global exhaustion.

Recent developments

In 1997 the Commission agreed to a request from the Council to launch a study via a third party on the economic consequences of the introduction of global exhaustion in trademarks. The study is likely to be completed early in 1999. The study will consider factors such as prices, trade volumes, availability, consumer effects, business effects and third country relations.

Interpretation of the Trademark Directive

In recent years, case law in EU member states has confirmed the applicability of EU-wide exhaustion. In Case C-355-96 *Silhouette v. Hartlauer* the European Court of Justice (ECJ) affirmed in July 1998 the single market intent of the EC Trade Mark Directive by ruling that the directive excludes a member state opting for international exhaustion. In the case C-352/96 *Phytheron International v Jean Bourdon*, the Court ruled in March 1997 that the origin of products was of no importance in determining the exhaustion rights of a trademark owner. Once a product is in circulation with the trademark owner's consent in one member state, then the owner's rights to oppose sale in another member state on the grounds of trademark infringement are exhausted.

This is important for European consumers as it means that *regional exhaustion* and *free circulation* allow goods from third countries once imported by the trademark owner into one country of the EU, to be available to all EU consumers. EU-wide exhaustion allows fair and relevant free trade.

The Impact on Brands

The BBG supports the concept of EU-wide exhaustion of rights since this enables goods to circulate freely through the EU as one single market. The BBG supports the view that countries joining the EU should be required to adopt the principle of EU-wide exhaustion.

EU-wide exhaustion:

1. Helps fair and level competition,
2. Helps ensure the consumer gets the product, pack and after-sales service expected,
3. Is integral to the EU single market and its benefits such as consumer and environmental protection.

1. EU-wide exhaustion helps fair and level competition

Advocates of global exhaustion claim that European prices are too high and that world prices of the same good are lower. Therefore, if parallel imports are allowed, the consumer will benefit. But, the starting point for competition between global markets is not level and it would be unwise to introduce global exhaustion on the assumption that it is. Where goods are available somewhere else in the world at prices lower than EU-average prices, there are two possible reasons:

Costs may be lower, for example if wage costs are low, if employer's social taxes are low, if packaging standards are low, if transport standards are low, if environmental standards are low, if media and advertising costs are low, if raw material costs are low, if taxes are low, if subsidies are high, if retail property costs are low, if productivity is high, or if trade prices are low. Low cost may have a high social cost when compared to European standards. In essence, the role played by cost in competition between global markets is not level.

Trading margins may be lower when there is an attempt to break-in to a new market. Global exhaustion is especially of concern for small and medium exporters who might suffer serious economic damage in their home market from parallel imports endangering R&D and future innovation. In essence the starting point for competition between global markets is not level.

2. EU-wide exhaustion stops nasty surprises

The expected product: A brand is not a commodity. A successful brand will innovate and change as it meets and anticipates the needs and tastes of the local consumer. For example:

- a brand of laundry detergent may be sold in 50 countries and will deliver the same consumer benefit (clean clothes) but formulations for cold-water hand-washing are not the same as for front-loading automatic machines;
- the flavour of some top-selling brands of toothpaste is different in Britain and Indonesia;
- face cream is formulated specially to work in the humidity of the tropics;
- a television for Asian terrestrial reception may not have the full band-width for European cable networks. If it did the Asian consumer would be paying for something they did not need;
- motor lubrication oils need to have special formulations for hot countries.

Also the product itself may be changing:

- limited-life products such as batteries may be near expiry by the time they reach Europe by parallel routes.

The expected pack: The same brand does not mean the exact same pack. Brand manufacturers in Europe ensure that their packaging conforms to European or national requirements such as labelling, re-usability and re-cyclability. The same brand sold outside Europe may well be packaged differently reflecting factors such as local manufacture, access to re-cycling plants, humidity, or local demand for small pack-size. Equally, pack graphics will differ to suit the local market (for example, a close-up of white teeth and red lips on a toothpaste pack is too sexually explicit for the Middle East market).

The expected instructions: A brand imported into the EU by a parallel trader may well contain instructions in non-EU languages. The consumer ends up either with instructions that are not understandable or no instructions at all if the trader decides to remove them.

The expected after-sales service: The European consumer expects good quality after-sales service when they buy a brand name good. That service is often provided by the official distributor. Parallel traders are not known for after-sales service. Furthermore, some parallel traders remove manufacturers' lot codes. This makes product recalls impossible.

Confusion and damage: Allowing global exhaustion and therefore the unrestrained parallel importation of famous brands from third countries would confuse the European consumer. In some cases global exhaustion will also lead to damage to the image of the brand in the European consumer's mind if the expected brand performance is not present. Brand image is also damaged when the expected after-sales service or guarantee is not available. Parallel trade can break the bond of trust between the brand owner and the consumer.

Counterfeits Channels of trade for parallel goods are ideal channels for counterfeits. Customs knowledge of regular shipping agents and ports, for example, helps distinguish counterfeits from originals. Parallel goods using different agents and ports will cause confusion. Global exhaustion will increase the flow of counterfeits to European consumers.

3. EU-wide exhaustion is integral to the single market

Competition EU-wide exhaustion is an integral part of the single market. Global exhaustion makes sense once there is a global single market, global market access, global free circulation of goods, global consumer protection, global social protection, global environmental protection, and the global enforcement of all intellectual property rights. Applying global exhaustion in isolation would place EU industry at a disadvantage to its competitors.

Environmental protection There is the danger that, were global exhaustion to be adopted, the price incentive for parallel trade may be a result of less developed environmental legislation in the country of origin. Regional exhaustion is an effective way to allow industry to help enforce EU laws designed to protect the environment.

Consumer protection Equally, unless there is an expensive 100% enforcement of EU labelling, packaging and other consumer protection rules, EU-wide exhaustion allows industry to help enforce those laws.

Consumer benefits of brands

Why parallel trade threatens the benefits

A brand is a constant point of reference which enables the consumer to make an informed choice appropriate to the purchase and usage occasion and which offers certain benefits:

- VALUE from higher quality delivered at competitive prices;
- CHOICE from brand diversity;
- CONVENIENCE from wide availability and ease of recognition;
- RELEVANCE to the consumer's needs;
- REASSURANCE as a result of trust in the manufacturer and the reliability of the brand;
- SATISFACTION from the purchase of, and identification with, the brand.

A parallel traded good may fail to deliver on all these benefits. It might appear to be good *value* but will it always be widely available? It will not be *relevant* to the consumer's needs if the instructions are missing. There is no *reassurance* when the brand seems different to the one expected. There is a loss of *trust* in the manufacturer and in the brand if there is no after-sales service or if there is a problem with the guarantee. Finally, there is a loss of *satisfaction* when the brand fails to deliver on all its promises because it turns out different from expectation.

Conclusions

Regional exhaustion is compatible and supportive of the internal market. It assists manufacturers to best meet consumer needs in the most relevant way. Regional exhaustion ensures consumer guarantees and reinforces the bond of trust between brand owner and consumer. It assists fair and level competition. It assists fair and relevant free trade.