



Moscow, October 2012

## **Memorandum**

### **Subject: Parallel Import**

#### **Legal Protection of Intellectual Property in the Russian Federation**

Uniting hundreds of European industrial companies, the Association of European Businesses (AEB) deems it necessary, on behalf of its member companies, to express its position on this matter. Of recent, the issue of parallel import – import of goods embodying intellectual work of means of individualisation carried out or implemented without the permission of the intellectual property owner, has been discussed frequently in the Russian Federation. This issue has attracted intense public interest and is, in fact, extremely important for many Russian and foreign companies working in the Russian market or planning to approach the Russian market.

It is the AEB's strong belief that the concept of parallel import will inevitably come into conflict with Russia's long-term interests; it neither promotes further development of Russian industry and localization of production units nor meets the interests of Russian consumers. An objective and impartial approach is required to the issue of parallel import, with comprehensive assessment of a number of significant aspects, rather than consideration of short-term interests of some of market's participants.

#### **Laws on Intellectual Property and Parallel Import**

The Fourth Part of the Civil Code of the Russian Federation (the Russian Civil Code) recognises exclusive rights to the results of intellectual activities and a means of individualisation. This exclusive right, also known as “a legal monopoly”, enables intellectual property owners to use the results of their intellectual activities and means of individualisation at their own discretion, thereby entitling them to prohibit or prevent others from using the outcome of their activities; the absence of a prohibition not being deemed equivalent to consent. Intellectual rights don't depend on the ownership right to an item in which relevant results of intellectual activities or means of individualization are expressed; transfer of ownership rights to an item does not entail transfer or grant of intellectual rights to the result of the intellectual activities and means of individualisation. According to the Constitutional Court of the Russian Federation<sup>1</sup>, prohibition by the intellectual property owner on use of the intellectual property by other parties is aimed at the execution of Part 1, Article 44 of the Constitution of the Russian Federation (“Intellectual Property is Protected by Law”) and limits the rights of commercial entities to the extent necessary for protecting the wellbeing, rights and lawful interests of others. Accordingly, use of the results of intellectual activities or means of individualisation by other persons without the consent of the intellectual property owner is illegal and entails civil, administrative and criminal liability.

<sup>1</sup> Resolutions of the RF Constitutional Court dated 20 December, 2001, N 287-O and 22 April, 2004, N 171-O.

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The import of goods bearing trade marks into the Russian Federation with the aim to introduce the goods in the civil turnover is recognized as a separate method of trade mark use. In addition, prohibition of such use of a trade mark is aimed at fulfillment of Russia's international obligations in the area of intellectual property protection, in accordance with the Constitution of the Russian Federation<sup>2</sup>.

To ensure a balance between the legitimate interests of rights owner and all other parties, the legislation has introduced the so called national principle of trade mark entitlement exhaustion (Article 1487 of the Russian Civil Code), which implies that a legal rights owner is not entitled to prohibit third parties from using a trade mark if the goods in question are introduced into the civil turnover on the Russian territory by the legitimate rights owner himself or with his consent. Russia, having become a member of the Customs Union, has ratified the Agreement on unified principles of regulation in the field of defense and protection of intellectual property rights which has come into force on January, 1, 2012. The present Agreement establishes the regional principle of trade mark entitlement exhaustion for Belorussia, Kazakhstan and Russia. Thus, article 13 of the Agreement says that the use of the trade mark in respect of goods which were legally introduced in the civil turnover on the territory of the member-states directly by the rights owner or other parties with his consent does not constitute violation of trade mark entitlement exhaustion.

The Agreement also establishes obligations of its parties to elaborate and introduce unified procedures which are necessary to ensure legal protection of trade marks on the territory of its states. The national and regional principles of trade mark entitlement exhaustion, applicable in Russia, are in line with the positive practice of many foreign countries, including the European Union, where, as in the Customs Union, the regional trade mark exhaustion principle is established.

#### **Anti-Monopoly Laws on Parallel Import**

The Federal Law "On Competition Protection" (Par. 4, Part 1, Art. 14) prohibits unfair competition, by which is understood, among other things, sale, exchange or other means of introducing goods into the civil turnover in case results from of intellectual activity were used illegally.

Any efforts to characterize the actions of the legitimate rights owners and Russian enforcement agencies aimed at struggling with parallel import and protection of intellectual property rights as monopolism or unfair competition is a substitution of terms, since the issue at hand is not the merchandise itself but the results of the intellectual activities, in particular, trade marks by which it is marked. Consequently, actions of the rights owner of the legal monopoly (exclusive right) to protect his rights are not and cannot constitute violations of the antimonopoly legislation which is confirmed by the provisions of the Part 4, Art.10 of the Federal law on protection of competition, and the legal monopoly of the rights holder in respect of objects of intellectual property does not exclude in itself competition on the market.

Parallel import discriminates against rights owners, their licensees, official importers and dealers in competition with parties importing goods without the consent of the rights owners. The former invest significant efforts and funds in promoting of brands and goods on the Russian market, including localising production units, constructing customer service centers, having goods certified and adapted, logistics, advertising, promotional campaigns, warranty and service maintenance, creating new jobs and training employees, etc., while the latter are merely economic parasites within an established infrastructure and often employ the 'grey schemes' for introduction of goods in the civil turnover, incurring, therefore, extremely insignificant business costs.

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<sup>2</sup> Resolution of the RF Constitutional Court dated 22 April, 2004, N 171-O.

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## **Import of Goods Marked by Trade Marks, Not for Entrepreneurship Aims**

The AEB realises that there is a certain gap in the legislation as regards protection of intellectual property rights when goods are imported into the Russian Federation by individuals for family, domestic or other non-entrepreneurship purposes. Even so, the AEB believes that such practices should not be deemed a violation of intellectual property rights of rights owners and should not lead to liability of physical persons. It is important to point out that in respect of such goods measures on intellectual property rights protection are not applied by customs bodies in accordance with paragraph 1, Part 2, Art.328 of the Customs Code of the Customs Union.

The issue of the import to Russia by legal entities or individual entrepreneurs importing branded goods into Russia, without the consent of the relevant rights owner for their personal needs requires, however, a more circumspect approach, including clarification in the legislation itself. If legal entities are given the absolute right to import branded goods for their personal needs without the consent of the rights owner, this might lead to abuses, with goods for actual subsequent resale being imported in the guise of goods for personal needs in violation of the rights owners' rights.

### **Parallel Import = Grey Import**

The existing practice of parallel import shows that parallel importers often employ various 'grey schemes' when importing goods to the territory of the Russian Federation, thereby cutting their own costs and providing them with competitive advantages in pricing. Parallel importers are called 'grey importers, not only because they violate intellectual property rights but also because they do not abide by generally accepted and transparent business practices and deliberately violate the existing laws or abuse gaps in the legislation.

According to customs and enforcement agency data, parallel importers in most cases submit misleading goods' declarations (including by underestimating their customs value, knowingly applying incorrect custom codes or merely declaring an underestimated quantity/weight of goods). In many cases, they use fly-by-night companies, numerous intermediaries and, sometimes, fictitious parties in order to avoid tax and duty payments. In addition, parallel importers often either illegally avoid having goods certified or use loopholes in the law to avoid doing so. Citing an example from the automotive industry, vehicles (sometimes even the new ones) imported by parallel importers do not receive a Russian "vehicle type approval", yet they are released on to public roads not being aimed at to use in the conditions in Russia. The other example can be the import of spare parts which is very frequently carried out with multiple violations (unreliable declarations, import of falsified and counterfeit goods, etc.). Moreover, import of spare parts by parallel importers without respecting rules of transportation and storage can lead to deterioration of the goods with further negative consequences for the customer.

The damage of "grey" goods including parallel import is rather substantial. Thus, according to D. Sugrobov, Head of the Principal Department on Economic Safety and Struggling against Corruption at the RF Ministry of Interior, "damage of "grey" goods in Russia attain 3 billion dollars"<sup>3</sup>.

### **"Legal" Parallel Import**

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<sup>3</sup> Source: RBC, 10 October 2012, <http://top.rbc.ru/economics/10/10/2012/673666.shtml>

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The AEB does not deny the possibility of a legal parallel import, by which is meant purchase of goods from the manufacturer (rights owner) and their import to Russia with its consent, which, proceeding from the special features of doing business or importing goods, does not limit import of these goods to Russia by persons other than an official importer and gives his consent thereto; import by big companies (e.g., large retail chains) of goods purchased directly from the manufacturer (rights owner) without going through its official importer (licensee) in Russia, for such organizations have an infrastructure that meets the requirements of the rights owner and Russian law. Import of goods (e.g., spare parts for vehicles) purchased from suppliers of components to the manufacturer of the finished products (e.g., car manufacturer), rather than from the manufacturer of the finished products, provided that the rights of such persons and existing agreements are not violated.

There is a number of other examples of “legal” parallel import that do not violate intellectual property rights. Such import is not illegal and no liability should be imposed for it. In addition, nothing stops Russian companies that wish to import goods to the Russian Federation from seeking and obtaining the consent of the rights owners. However, practice shows that unfair parallel (grey) importers never make such applications, this constituting further evidence of their lack of interest in conducting legal business.

### **Economic Aspects of Parallel Import:**

The activities of parallel importers are not aimed at long-term business development, as they are primarily determined by today’s speculative opportunities: in most cases, the decision whether or not to import goods is determined on the basis of the currency market, as well as by the opportunity to minimize overheads. This was confirmed in the first months of the economic crisis in Russia, when the volume of parallel import and activities of parallel importers in some industries decreased virtually to zero, as their business became economically unprofitable, while rights holders, licensees, official importers and dealers continue to make all possible efforts to support their business and maintain jobs in Russia.

Recently, when consequences of the crisis take less importance, activities of parallel importers have become more active. AEB is of the opinion, that parallel import puts a brake on localization of production units belonging to foreign producers (rights holders) in Russia and reduces to a minimum the market for goods legally imported into Russia. This does not, indeed, correspond to the Russian Federation’s objective relating to industrial development and switching from an economy focused on exporting raw materials and importing consumables to a high-tech economy and then an innovative one.

As parallel import is virtually always associated with import of goods with understated customs values, it reduces custom payments, taxes and other financial contributions to the budget. Certainly, the “greyest” forms of parallel import (in particular, misleading declarations and use of fly-by-night companies) have an even more significant impact on such contributions.

### **Parallel Import in Terms of Consumer Rights and Interests**

The adverse consequences of parallel import are multifaceted, infringing on the rights of not only rights holders/owners and their authorized representatives but also those of Russian consumers:

- Parallel importers in most cases import goods that either the manufacturer did not intend for Russia or require additional adaptation to the standards existing in Russia, which the importers fail to do. For example, automobile manufacturers adapt vehicles to operate under certain climatic conditions, in the process adapting them to the specific environmental and safety requirements and other standards and

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technical regulations existing in Russia. This is almost always not done by the parallel importers, who merely import the vehicles without taking into consideration the need for adaptation of lighting units, radio-frequency, climate and other equipment and settings.

- Parallel importers, as well as distributors of the goods they import, almost never render additional services to consumers, for example, prolonged guarantee, special conditions of financing special trade-in programs of used cars, disposal programs, etc. In particular, they do not provide the proper information support (e.g., information about the goods in the Russian language); warranty and service maintenance (in particular, they send consumers to official importers and dealers and do not go to the trouble of satisfying their needs themselves);
- Parallel importers do not satisfy other claims regarding goods quality (e.g., the right to exchange and return), don't put marking, provide certification of goods through dishonest certifying centers with the aim to obtain easy profit creating unsafe conditions for use of home appliances or gas-burning goods by the Russian consumers in future because the quality of testing and research for compliance with technical regulations are not guaranteed by these certifying centers

### **Consequences of Parallel Import Liberalisation**

Parallel import liberalisation (in particular, abolition of the national/regional trade mark right exhaustion principle) will have the following consequences at the very least:

- Mechanisms for intellectual property protection provided for by the Customs Code of the Customs Union, as well as the intellectual property registers, making it possible among other things, to combat infringement of legal goods importation processes, will cease to operate effectively.
- It will become virtually impossible for the enforcement agencies to combat import to the Russian territory and subsequent turnover of counterfeit goods and goods imported in violation of intellectual property rights, as it will be difficult (especially at the import stage) to detect illegal use of trade mark (in particular, because a counterfeit good might be introduced into circulation in a foreign country without any violation of the rights holder's rights in that country). Protection of rights by rights holder in civil proceedings will, of course, fail to counter violations effectively because of weak mechanisms of protection.
- A significant rise in the import of goods not designed for the Russian market, as well as counterfeit goods, should be anticipated, especially taking into account Russia's geographical proximity to some Asian countries. Accordingly, there will be a significant increase in the risk of Russian consumers purchasing such goods.
- Development in Russia of fair competition, with equal opportunities for market players developing their businesses legally and in good faith and investing in the Russian economy, will be brought into question.
- Local industrial production will stop increasing (or even begin falling), for companies producing goods in Russia will start losing out in the unfair competition with parallel importers.
- Tax and duty revenues into the Russian budget from import of goods and their subsequent turnover in Russia will fall.

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- Traditional Russian producers can face the situation when goods marked by their trademarks will be imported to the Russian territory legally while such trademarks could be registered in any other state (in case of absence of international registration with Russian rights owner or registration in such a state). Therefore, national industry (the automotive one at first place) can face a massive import of fake Russian goods produced abroad and purchased in Russia at a lower price.
- All of the above will, in aggregate, inevitably reduce the appeal of the Russian market. It will affect further investment in the economy and, naturally, the overall volume of goods legally supplied and produced, with all the ensuing negative consequences.

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