

# MEMORANDUM ON PARALLEL IMPORTS

## SUBJECT: PARALLEL IMPORTS

Uniting hundreds of European and international industrial companies, the Association of European Businesses (AEB) deems it necessary, on behalf of its member companies, to express its position on the principle of exhaustion of exclusive rights, or parallel imports.

Parallel import – the import of goods embodying intellectual work of means of individualisation carried out or implemented without the permission of the intellectual property owner. This issue has attracted intense public interest and is, in fact, extremely important for many Russian and foreign companies working on the Russian market or planning to approach the Russian market.

At present the Eurasian Economic Commission is drafting changes to the Treaty on the Eurasian Economic Union (EEU) of May 29, 2014 which provide for exemptions from the regional principle of rights' exhaustion regarding certain goods. Moreover, proposals on the order, selection criteria of goods towards which these exceptions are supposed to be introduced, are also under discussion. This means in fact partial legalisation of parallel imports. On the other hand, the Federal Antimonopoly Service (FAS) of Russia suggests a gradual transition towards international principle of rights' exhaustion and legalisation of parallel imports with regards to certain goods.

It is the AEB's strong belief that the concept of parallel imports will inevitably come into conflict with Russia's long-term interests; it neither promotes the further development of Russian industry, import substitution or localisation 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.

The AEB believes it is important to state that we do not support the legalisation of parallel imports neither fully (for all industries) nor partially (via pilot projects). The AEB believes that such experiments would be very risky, especially in light of the economic crisis.

The AEB notes that investors came to the Russian Federation with the regime of the regional rights' exhaustion principle (full ban of parallel imports) and any change will give thought for reconsideration. Moreover, apparent difficulties in administration of possible exclusions from the current regime or a full transition to the

international principle of rights' exhaustion principle may also lead to corruption which will also worsen a business environment.

## LAWS ON INTELLECTUAL PROPERTY AND PARALLEL IMPORTS

To ensure a balance between the legitimate interests of rights owners and all other parties under the Eurasian Economic Union (EEU) treaty dated 29 May 2014 (Annex 26 Protocol on the protection and defence of the rights of intellectual property, hereinafter referred to as the Protocol), of which Russia is a member, the regional principle of exhaustion of rights is asserted. In paragraph 16 of the Protocol it states that "no use of the trademark and/or the trademark of the Union in relation to goods which have been lawfully placed on the market of member states directly by the right holder of the trademark and/or the trademark of the Union or any other person with the right holder's consent shall constitute an infringement of the exclusive right to the trademark and/or the trademark of the Union".

Article 1229 of the Russian Civil Code states that there is an exclusive right to the results of intellectual activity and means of individualisation. This exclusive right, being a so-called "legal monopoly" allows the right holder to use at its discretion the results of intellectual activity and means of individualisation, prohibit or authorise others to use them. The absence of prohibition is not considered consent. In accordance with Article 1227 of the Civil Code, intellectual rights do not depend on the ownership of the item which the corresponding results of intellectual activity or means of individualisation relate to, and transfer of ownership of the item does not entail the transfer or provision of the right to the result of intellectual activity or means of individualisation. As the Constitutional Court of the Russian Federation has stated<sup>1</sup>, the prohibition by the rights owner of the use of its intellectual property is aimed at the implementation of p. 1, Art. 44 of the Constitution of the Russian Federation ("Intellectual property is protected by law"), and limits the rights of economic entities to the extent that this is necessary in order to protect the health, rights and lawful interests of other persons. Accordingly, the use by others of the result of intellectual activity or means of individualisation without the consent of the rights owner is illegal and entails civil, administrative and criminal liability.

The importation of goods into Russia with a trademark in order to sell the goods on the domestic market is an independent method of using that trademark. The prohibition of this method of using the trademark is aimed at compliance with Russia's international

<sup>1</sup> See i.e., the definition of the Constitutional Court of the Russian Federation dated 20/12/2001, No. 287-O and 22/04/2004 No. 171-O.

obligations in the field of intellectual property protection in accordance with the Constitution of the Russian Federation.<sup>2</sup>

Before the adoption of the fourth part of the Civil Code, the national principle was enshrined in Article 23 of the Federal Law "On trademarks, service marks and appellations of origin", dated 1992. In 2002, changes were adopted, and the previous international principle of exhaustion of rights was replaced by the national principle. These changes, and the ensuing adoption in 2006 of the fourth part of the Civil Code (Art. 1487 of the Civil Code), show how Russian legislation on the protection of intellectual property rights has been gradually developing. A return to the international principle of exhaustion of rights would mean a return to the past, would be a negative example of the instability of Russian legislation for international right holders and investors, many of whom have localised their production facilities in Russia and expect a high level of protection of their intellectual property rights when taking relevant decisions.

### **INTERNATIONAL EXPERIENCE**

With regard to international experience in the application of the principle of exhaustion of rights, the regional principle of exhaustion of rights is asserted both in the European Union and the Eurasian Economic Union.<sup>3</sup> Virtually nowhere is parallel import allowed unconditionally, even in the US, which is often referred to by supporters of the authorisation of parallel importation, there is no international principle of exhaustion of rights in its purest form. Moreover, the recent US "first sale doctrine" is subject to substantial revisions, including with regard to copyright.<sup>4</sup>

### **ANTI-MONOPOLY LAWS ON PARALLEL IMPORTS**

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 characterise the actions of the legitimate rights owners and Russian enforcement agencies aimed at struggling with parallel imports 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 centres, 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.

### **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 IMPORTS = GREY IMPORTS**

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

<sup>2</sup> See the definition of the Constitutional Court of the Russian Federation dated 22/4/2004 No. 171-O.

<sup>3</sup> Art. 7 Council Directive "On the harmonisation of the laws of the member states in regards to trademarks" dated 21 December 1988 (89/104/EEC).

<sup>4</sup> See cases reviews by the Supreme Court of the USA, for example, the case of Quality King Distributors Inc., v. Lanza Research International Inc., 1998; the case of Costco Wholesale Corporation v. Omega, S.A., 2010 etc.

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 losses from "grey" products, including direct parallel imports are rather large, and together with "grey importation", according to various estimates, may reach USD 3 billion.

### OTHER TYPES OF PARALLEL IMPORTS

The AEB does not deny the possibility of import of goods, purchased from the manufacturer (rights owner) and their import to Russia with his 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 organisations 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 IMPORTS

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 minimise overheads. This, for example, was confirmed in the economic crisis of 2008 as well as the current situation, when the volume of parallel import and activities of parallel importers in some industries has decreased virtually to zero, as their business has become economically unprofitable, while right holders, licensees, official importers and dealers continue to make all possible efforts to support their business and maintain jobs in Russia.

The AEB is of the opinion, that parallel import puts a brake on localisation of production units belonging to foreign producers (right 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.

The legalisation of parallel imports will also not contribute to the policy of import substitution, including in relation to those companies that are only planning to localise their production facilities. Part of the domestic production can be substituted by imports, including parallel imports.

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

Also, in the case of the legalisation of parallel imports, any possible reductions in prices, if at all happens, would be short-lived and insignificant, affecting mainly the wholesale markets due to unfair competition, and consumers not been provided the entire range of services stipulated by consumer protection law.

### PARALLEL IMPORTS IN TERMS OF CONSUMER RIGHTS AND INTERESTS

The adverse consequences of parallel imports are multifaceted, infringing on the rights of not only rights holders/owners and their authorised 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 technical regulations ex-

isting 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 programmes 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), do not put marking, provide certification of goods through dishonest certifying centres, 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 centres.

### CONSEQUENCES OF PARALLEL IMPORTS LEGALISATION

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

- A decline in Russia's investment appeal in Russia: according to the study of GfK-Rus<sup>5</sup>, 17 of the 34 companies stated that investment attractiveness in Russia would worsen in case of parallel imports' legalisation and 4 companies informed that that they would terminate their investment programmes.
- 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 of fair competition in Russia, 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.
- The danger to the health and safety of consumers would increase significantly, as well as the risk of the importation and subsequent acquisition of consumer goods which are not destined for the Russian market.
- Tax and duty revenues into the Russian budget from import of goods and their subsequent turnover in Russia will fall.
- There is the risk of violating WTO rules in cases of the discrimination of some companies in relation to others (for example, the implementation of the so-called "pilot" projects involving the legalisation of parallel imports for particular product groups).

### THE IMPLICATIONS OF PARALLEL IMPORTS FOR INDIVIDUAL INDUSTRIES

#### The drugs and medical equipment market

1. If drugs and medical equipment were imported into Russia unchecked, it could adversely affect the safety of the consumer. Currently, the manufacturer provides quality control of the production process and compliance with the international GMP standards, and if parallel imports fell out of the chain, the consumer would suffer. When introducing parallel importation, it would be too difficult and expensive to organise a proper mechanism to check the quality of imported medicines.
2. Now the process of harmonising Russian legislation in regards to drugs with the laws of the EEU is underway, and the legalisation of parallel imports could bring this to a halt.
3. Given the large volumes of imports of drugs, problems may arise at customs: at the moment there is no appropriate infrastructure (laboratories, quality control agencies and so on), and creating this would require significant financial resources on the part of the EEU member states. Delays in the release of goods can lead to disruptions in the supply of drugs.
4. In the EEU member states there is an effective distribution network, with all the participants of the distribution network obliged to maintain product quality, provide the necessary instructions for end users and maintain the quality and technical compliance during operation (for medical devices). Representatives of the manufacturer regularly conduct quality audits. The parallel importer that is not part of the manufacturer quality system is not responsible for providing products to the consumer and end user in the proper form.

<sup>5</sup> Hereafter the figures are taken from a study by GfK-Rus "The financial and economic impact of the liberalisation of parallel importation in Russia", commissioned by the AEB in 2013.

### The automobile spare parts market

1. On the market at the moment there is a strong competition between brands.

2. With the legalisation of parallel imports it is projected that there will be a rise in unfair competition (for example, by reducing “costs” on warranties, technical inspections and certification, advertising, etc.).

3. It is projected that there would be an increase in the supply of parallel imports through so-called tax havens, which would reduce tax revenues to the state, and lead to unjustifiably low (dumping) prices for spare parts in the EEU. As a consequence, there would be a drop in interest on the part of the producers, particularly on the Russian market, which is going through hard times due to the crisis, a decrease in the purchasing power of the population and a drop in sales.

4. There would be a significant increase in the imports of counterfeit goods into Russia especially under the guise of parallel imports: according to a study conducted by GfK-Rus the largest share of counterfeit goods is expected by representatives of manufacturers of auto parts – up to 30–50%. If you change the exhaustion regime they would lose the ability to control the importation of counterfeit goods.

5. As a result of the legalisation of parallel imports job related to manufacturing car parts and after-sales service are expected to drop (20–60% depending on the sector).

6. In the event of the legalisation of parallel imports the level of investment in Russia would decrease by 30–50% depending on the sector. The greatest reduction would occur in the automotive industry – about 60–70%.

7. The legalisation of parallel imports would lead to a lack of adequate guarantees of the quality of goods. “Unauthorised” parallel importers would not be responsible for after-sales service, or the technical condition of the imported parts, as it would not be in their financial interest.

Overall, the legalisation of parallel imports would inevitably reduce the appeal of the Russian market, lead to a further reduction in investment in the economy, and the volume of legally supplied and manufactured goods – with all the attendant negative consequences.