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14 October 1999

Legislative Council Secretariat
Secretary to Legislative Council
Bills Committee on Trade Marks Bills
3/F Citibank Tower
3 Garden Road
Central
Hong Kong

For the attention of Ms. Odelia Leung

Dear Ms. Leung,

Please find attached a petition from:

Unilever Hong Kong Ltd., Colgate-Palmolive (H.K.) Ltd., Levi Strauss & Co., Johnson and Johnson (Hong Kong) Ltd. and PepsiCo, Inc.

Our contact person is Mrs. Eva Kwan of Unilever Hong Kong Ltd. If we are granted a hearing before LegCo, please contact Mrs. Kwan at 2892-3128 (telephone) and 2834-6309 (fax).

Thank you very much for your kind attention.

**To: The Bills Committee of Trade Marks Bills
Legislative Council**

Attention: Ms Margaret Ng

**cc: Intellectual Property Department
The Government of the Hong Kong Special Administrative Region
24th Floor, Wu Chung House
213 Queen's Road East
Hong Kong**

Submission

Introduction

1. This paper is submitted by the undersigned companies. We support the Government's initiative to modernise Hong Kong's trade mark law. But this submission highlights serious objections to Clause 19 of the Bill, which is designed to introduce "international exhaustion" of trade mark rights.
2. The reason given by the Intellectual Property Department for the introduction of Clause 19 is to provide "in clearer terms than the Trade Marks Ordinance the circumstances under which such rights will be exhausted". We believe that this is an oversimplification of the current law relating to "exhaustion of rights" in respect of trade marks. Firstly, the Trade Marks Ordinance does not provide at all for circumstances under which such trade mark rights will be exhausted. Secondly, the principles relating to "exhaustion of rights" as currently applied in Hong Kong are case law principles established by principally the English Courts (under the UK 1938 Trade Marks Act).

Under case law, generally, parallel importation of goods produced abroad is permissible if these goods were produced abroad (in the course of which the trade mark is applied on the goods) with the consent of the Hong Kong trade mark owner and subsequently sold without any notice or restriction or prohibition (express or implied) on export or dealing outside the country of manufacture. If a trademark is applied on a territorially limited basis by a licensee or associated company or if the proprietor has established distinctive marketing pattern or suitable disclaimers to negate any implied licence to resell goods first sold under the mark elsewhere, the current case law position is that it should be possible to restrain parallel imports as trademark infringements. Clause 19 clearly widens the application of the current case law principles of "exhaustion of rights" by the inclusion of the words "with his consent (whether express or implied or conditional or unconditional)".

3. "International exhaustion" would mean that trade mark owners and their distributors/licensees would be unable to oppose the importation into Hong Kong of authorised goods sold at lower prices under the same trade mark through different distributors/licensees in other countries. International exhaustion would have many negative effects, including:
 - damage to the interests of Hong Kong manufacturers and other brand owners by creating a significant disincentive to exploit export markets;
 - forcing brand manufacturers to develop brands on the basis of Hong Kong costs, but compete on the basis of prices in the cheapest global market - this is not economically sustainable;
 - upward pressure on prices within Hong Kong if brand owners withdraw from lower margin markets and can no longer spread fixed costs over a wide volume of sales;

- damage to the interests of consumers in Hong Kong by generally undermining the effectiveness of trade marks in assuring quality and identifying origin;
- confusing consumers where goods sold under the same trade mark are (quite legitimately) in fact different - some products are tailored to different national markets where there are different needs and therefore although such products may bear the same trade mark, they may differ in quality, composition, style or packaging (the differences may not be sufficiently substantial to fall within the scope of the exceptions provided in Clause 19 of the Bill);
- reducing the ability to detect and prevent counterfeits;
- particular difficulties and unfairness where goods are marketed in other countries which have not extended international exhaustion; and
- flying in the face of reasoned decisions taken in other countries, e.g. not to extend international exhaustion, to carry out detailed studies or to proceed only with significant safeguards.

In short, by introducing international exhaustion unilaterally into its own law, Hong Kong risks disadvantaging itself against its trading partners around the world and damaging the interests of Hong Kong businesses and consumers.

Why international exhaustion should not be supported?

4. The usual policy argument in favour of international exhaustion is based on the assumption that allowing parallel imports would promote international trade and reduce prices for some branded goods in Hong Kong (since lower priced equivalent imported goods would compete with those sold here by the trade mark owner or his authorised licensee/distributor). But this assumption is highly questionable and the argument oversimplifies the commercial policy considerations involved.¹ Current studies indicate the assumption may well be wrong.
5. The European Commission is currently investigating the commercial policy considerations arising and has recently commissioned an economic study by National Economic Research Associates (NERA). The NERA report describes the economic issue as follows:

“From an economic point of view, there is nothing intrinsically bad about price discrimination. Some form of price discrimination is common and efficient in situations where fixed costs have to be covered, and as our brief description of related intellectual property issues in the pharmaceutical sector indicates, there may be significant benefits in terms of both economic efficiency and consumer welfare when firms are allowed to practice it. There can be no a priori presumption that prohibiting price discrimination in a

¹ As advocate General Jacobs recognised might be the case in his Opinion in the landmark *Silhouette* case in the European Court of Justice, at paragraph 51.

particular case will result in prices in a particular market falling to the lowest of the different market prices. They may rise to higher levels, and the trademark holder may withdraw from the low price markets altogether”.

6. NERA’s study shows² that in the European Union, substantial price differences for particular branded products between different Member States still exist, even though it has not been possible, for many years, to use trade mark laws to prevent parallel imports into one EU Member State from another. This is so, for example, even in cosmetics and perfumes where there are large scale parallel imports within the EU. This data is not consistent with the theory that allowing parallel imports will significantly reduce prices and at the very least demonstrates that the economic issues are far more complex than the proponents of international exhaustion appreciate or admit.

7. *Negative economic consequences*

7.1 It is vital for Hong Kong’s future to encourage Hong Kong companies and individuals to develop new products and brands and market them internationally. Introducing international exhaustion would, over time, inhibit investment in new marks and potentially lead to a reduction in advertising activities.

7.2 Hong Kong based distributors/licensees of international brands would suffer. Commonly, international brands are distributed through exclusive distribution/licence arrangements for particular territories. In return for his exclusivity, the distributor/licensee often shares the cost of promoting and advertising the brand, providing after-sales services and complaint hotlines as well as research and development of products in his territory. Parallel imports mean the distributor faces competition from those who do not bear a share in this cost. The willingness of Hong Kong entities to enter into such arrangements would be affected. Employment would suffer in consequence and, ultimately, the availability to the consumer of the highest quality products (and, in some cases, associated services) may be reduced.

7.3 In a situation where major trading partners of Hong Kong do not themselves apply international exhaustion, Hong Kong manufacturers would have to compete at a disadvantage with manufacturers in those countries which do not, who would therefore have the unfair advantage of a protected home market.

8. *Adverse consequences for the consumer*

8.1 The proponents of international exhaustion make the fundamental mistake of treating the world as a single market place. This is not the reality. Many products sold internationally under a single brand vary in nature, quality, composition or standards, according to local market tastes or regulatory requirements. It is undesirable for Hong Kong consumers to be confused into buying what they believe to be the product with which they are familiar, based on its brand, only to find it is different. This, however,

² See Table 4.1.

is a consequence of parallel imports in the field of trade marks (unlike the case of copyright).

- 8.2 Goods sold under the same trade mark in other markets may not meet Hong Kong technical or safety standards, may have deteriorated in quality or may have become outdated.
- 8.3 Permitting parallel imports can only make more difficult the identification and prevention of counterfeits, thus assisting the counterfeiter and harming the consumer.
- 8.4 Parallel imports generally have a shorter shelf-life and the quality may have deteriorated or damaged in the course of improper transportation. Parallel importers would aim to obtain the parallel import at the cheapest possible price and to keep transportation cost to the minimum, thereby possibly sacrificing the quality of the product.
- 8.5 Parallel imports may not comply with Hong Kong technical safety or labelling standards and it may be difficult to enforce such standards on parallel imports - this may result in risks to consumers.

9. *International caution*

- 9.1 Arguments in favour of international exhaustion did not convince the European Union when the Directive to harmonise trade mark laws was adopted in 1989. The EU, particularly concerned about lack of reciprocity and damage to commercial and economic interests with the EU, rejected the idea of introducing international exhaustion.

The European Commission had originally introduced international exhaustion in its proposal for a first Council Directive to approximate the law of the Member States relating to trade marks in 1980.

However the Economic and Social Committee were concerned with the question of reciprocity. The reason they gave was that the principle of the international exhaustion of the right to a mark is not universally recognised and to include it in an EEC instrument would damage Community undertakings internationally.

The European Parliament also rejected the idea of international exhaustion. Thus the Council Harmonisation Directive 89/104/EEC of 21 December 1988 only introduced EEA-wide exhaustion.

This suggests that although there is a case for international exhaustion to promote free trade at international levels and price reduction promoters of international exhaustion may be oversimplifying the commercial policy considerations. Advocate General Jacobs also indicated this in his opinion in *Silhouette*.

- 9.2 Subsequently, the issue has become more controversial, but policy within most EU countries (notably France, Germany and Italy) remains hostile to international exhaustion. Even in the United Kingdom, one of the most supportive countries,

considerable caution has been urged. In its June 1999 report on the subject the influential House of Commons Trade and Industry Committee - after setting out all the arguments at length - pointed out that there is a deficit of empirical research measuring the impact of international exhaustion, both short and long term. The Committee concluded:

- it would be imprudent for the European Commission or Member State governments to come to any final decisions without further study;
- although in some areas, the benefits may outweigh the dis-benefits, in other sectors the problem of international exhaustion would outweigh the advantages;
- while moving towards a broad principle of international exhaustion, there should be:
 - (a) protection in those sectors where detrimental effects could be shown; and
 - (b) procedures for labelling grey goods which are materially different to those of the same brand on the domestic market.

The UK government has recently endorsed these conclusions, but appears to accept the difficulties of persuading other European governments to go even this far.

9.3 Article 6 of the Trade Related Aspects of Intellectual Property Rights Agreement provide that “nothing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights”. Trade Related Aspects of Intellectual Property Rights will therefore not prevent a country from excluding international exhaustion.

9.4 Research on the question of “exhaustion of trade mark rights” has also been conducted by the Parallel Imports/Exhaustion Subcommittee of the Issue and Policy Committee of the International Trademark Association (“INTA”). INTA is “an international association of trade mark owners and associated professionals dedicated to promoting the role of trade marks world-wide”. INTA’s membership includes more than 3,200 corporations and firms in 117 countries, including major multinationals and smaller companies that recognise the importance of trade marks to world commerce. The Subcommittee’s analysis includes a research on legislation and case law in various jurisdictions as well as treaties in certain regional groupings. The Subcommittee found that, in general, most countries favor some concept of national exhaustion. Based on the analysis and recommendation by the Subcommittee, the Board of Directors of INTA passed a resolution in May 1999 to support the principle of national exhaustion of trade mark rights. It is understood that INTA has submitted its comments and views to the Hong Kong Government indicating its support for the national exhaustion principle.

9.5 Clause 19 of the Hong Kong Bill has not been based in any empirical research or analysis. It is diametrically opposed to laws in the EU and elsewhere. It does not contain provision for a sectoral approach, or for any of the other safeguards, which even supporters of international exhaustion agree to be necessary.

Conclusion

10. The issue is an issue of economic and commercial policy. The arguments in favour are suspect, and these are powerful arguments against. The European Union has in the recent past rejected international exhaustion for fear it would damage its economic position. For Hong Kong unilaterally to introduce international exhaustion would risk damaging the economy and consumers’ interests. To introduce international exhaustion now, without proper study and consultation, would be to ignore the possibility that parallel imports of branded goods may be damaging, not beneficial, to the economy. Other countries have recognised the complexity of the economic and commercial issues involved and are currently studying them. Hong Kong should do likewise.

We hereby ask for an opportunity to appear before members of the Bills Committee to discuss our concerns and to answer any queries any member may have. We look forward to hearing from you.

For and on behalf of
Unilever Hong Kong Ltd.

For and on behalf of
Colgate-Palmolive (H.K.) Ltd.

For and on behalf of
Johnson and Johnson (Hong Kong) Ltd.

For and on behalf of
Levi Strauss & Co.

For and on behalf of
PepsiCo, Inc.