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Client Briefing
November 2011

Japan - Parallel Imports: Which legal framework?

The bitter taste of a "grey market"

The main channel for importing high quality goods in Japan is through retailers and other official intermediaries: products are imported by Japanese wholesalers, distributors or agents (who are often structured as a local subsidiary of the intellectual property rights (IP) owner). An alternative route is that of parallel imports, which involves the import and resale of non-counterfeit goods without the relevant IP owner's consent. These goods are commonly exchanged in the Japanese "grey market" which thrives on price differentiation between countries. Such market conditions promote the purchase of goods in a country where the price is cheaper for legitimate resale in other countries where their price is significantly higher. Whilst these trades usually take place at retail level, they may sometimes take the form of wholesale purchases. The European luxury goods industry has clearly suffered from the adverse effects of such strategies as regularly practiced in the Land of the Rising Sun. Typically, genuine products are purchased from abroad and imported into Japan, where they are sold at a price that exceeds their original purchase price yet is less than the local price set by official distributors (including department stores and shops managed directly by the IP owner).

A tale of tolerance and hostility

Parallel imports raise important questions, in particular, why are they considered harmful by IP owners and their licencees? A number of economic and organisational reasons can be advanced. Firstly, such imports typically disorganise the manufacturer's distribution network in a given territory. In the absence of parallel imports, authorised distributors would benefit from a strategic exclusivity by virtue of their monopoly in the Japanese market. Parallel imports force such exclusive or authorised distributors to reduce their prices and profits to compete with incoming and unwanted competitors. As such, parallel imports can benefit the consumer. This is particularly so where a manufacturer or retailer implements a distribution strategy based on vertical restrictions, such as resale price maintenance or discriminatory restrictions based on territory as a means to limit competition in a market. In this context, Japanese case law provides considerable guidance on unlawful vertical agreements involving cartels and vertical restrictions on competition resulting from attempts to protect a distribution network against opportunistic behaviour and the harmful effect of parallel imports.

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The most common annoyance to IP owners and their licencees is a practice known as "piggy-backing" which refers to the parallel importer's attempt to cash in on the goodwill fostered by the IP owner or an authorised distributor to sell its grey goods: free-riders distort competition by taking advantage of a competitor's reputation and brand image and promoting confusion among consumers to divert customers. However, whilst vertical agreements produce certain anti-competitive effects such as collusion and market foreclosure, they may also promote market efficiency. When confronted with active parallel imports, local exclusive or authorised distributors or agents may become more reluctant to invest, innovate, launch new advertising campaigns, or offer extra sale, pre-sale or after-sales services in order to reduce their costs. At least some of these business methods may be in the consumer's best interest. Higher prices may therefore be justified to cover the added value of the additional services provided.

Radical developments and substantive law

In Japan in the 1960s, parallel imports of genuine goods were considered a violation of the local brand distributor's IP rights and were condemned by case law (*Parker pens, Nestlé coffee, Bayer aspirin, etc.*). However, in another Parker case in 1970, the Osaka District Court ruled that, under certain circumstances, parallel imports of genuine products did not amount to a specific violation of the rights of Parker's official distributors. In 1972, the Ministry of Finance issued a directive stating that parallel imports of genuine goods did not, in principle, amount to a trademark infringement.

The key legislation under Japanese competition law is the 1947 Antimonopoly Act (the Act). The Japan Fair Trade Commission (JFTC) considers parallel imports as beneficial to consumers in general. This is expressly stipulated in its "*Guidelines concerning distribution systems and business practices under the Antimonopoly Act*" dated 11 July 1991. The obstruction of parallel imports, if it is conducted to maintain the price level of the products covered by an exclusive distribution contract (and not, say, to prevent consumer misunderstanding due to differing product specifications or a false indication of origin or to protect consumer health or safety caused by the deterioration of quality) is a problem under Article 19 of the Act[1]. The implementation of measures seeking to restrict a parallel import solely to maintain the price of a product marketed under an exclusive distribution contract is in breach of Article 19 of the Act.

As defined in Article 2 of the Act, “unfair trade practices” are detailed in Article 2 of the Act and in a list published by the JFTC (Notification No. 15 dated 18 June 1982). The list includes interference with a competitor’s transactions and obstruction of parallel imports[2] as an instance of unfair trade practice.

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[1] Article 19 of the Act states that no entrepreneur shall resort to unfair anti-competitive practices. Paragraph 1-(2) of Chapter 3 of Part III of the Guidelines provides that in principle taking action to protect a trademark does not pose a competition law problem (a) where there is a risk of confusion among consumers between products distributed by an exclusive distributor and similar goods, even where this relates to their specification or quality, due to a false indication of origin or for any other reason; or (b) where a product (even if legally sold in another country) may potentially harm the reputation of a locally distributed product by containing a threat to the consumer's health or safety through the deterioration of its quality.

[2] Designation (14): "Unjustly interfering with a transaction between another entrepreneur who is in a domestic competitive relationship with oneself or with the corporation of which one is a stockholder or an officer, and its transacting party, by preventing the effecting of a contract, or by inducing the breach of a contract, or by any other means whatsoever."

Rulings favouring parallel importers

Whilst a number of legal rulings have been made in this area, particularly in the late 1990s, they have become less common in recent years. The sectors the cases have involved are diverse and have included products such as Parker pens, Steinways pianos, Seagull water purification devices, Herend china, Nike footwear, Häagen Dazs ice cream and Dunlop tyres. The decisions typically involved a foreign IP owner that manufactured goods for sale by a Japanese distributor and a parallel importer acting independently. The parallel importer purchased goods from foreign wholesalers or other official distributors, who then became subject to commercial pressure, duress or retaliation from the IP owner. In some instances, the IP owner withheld supply to the offending distributors selling to the parallel importer in an attempt to end the parallel chain of supply. In the majority of cases the JFTC would start investigating and if the practice does not stop, it will issue a cease and desist to the IP owner demanding that the IP owner cease its wrongful behaviour (considered to be a breach of Article 19). As a result, impeding parallel imports is generally a prohibited practice in Japan. Any attempt to hinder a parallel importer's advertising or promotional activities would be considered illegal (importers are able to use the brand and its logo on their shop windows and websites, provided this does not harm the brand in Japan or amount to an unfair trade practice). Any attempt to obstruct the purchase of goods in foreign markets destined to be sold as parallel imports in Japan is prohibited on a similar basis. If a parallel importer considers that the aim of an IP owner's actions is to impede its imports, it can file a report to the JFTC who may initiate an enquiry. Consequently, taking measures against parallel importers remains a sensitive matter.

There are a few secondary measures which could help restrict parallel imports including the commencement of legal proceedings on the grounds of a copyright infringement. However, such legal proceedings often lead to pyrrhic victories as the parallel importer is not seriously affected. For example, the unauthorised use of visuals on a parallel importer's website (assuming the copyrights are owned by the manufacturer and not the advertising company, which is not typically the case) or of a manufacturer's text would be unlawful if prior consent was not granted by the IP owner, and in either case the IP owner could demand their withdrawal.

Proceedings can also be commenced on the grounds of trademark infringement if a visual is combined with the logo and the brand by a creative parallel importer. Unfair competition, even that which results in increased competition, is another angle of attack. The burden of proof lies on the plaintiff who must prove that the parallel importer's activities create confusion in the mind of the public. An example would be a parallel importer suggesting or implying that it and the official importer belong to the same group or are operating under a close business relationship. In general, a market study would need to be conducted in order to prove unfair competition.

Trademarks

In Japan the trademark owner also retains the trademark's exploitation rights. As noted above, parallel imports were formerly considered to be an unauthorised import of registered trademark goods, without the IP owner's consent. As such, any resulting sales were deemed to be a trademark infringement. Today, parallel imports of genuine goods no longer amount to counterfeiting, even where the IP owner has not granted a licence to permit the activities. In a Supreme Court ruling of 27 February 2003, the court prescribed three conditions which needed to be fulfilled for imports of genuine goods not to amount to trademark infringement in Japan: (i) the trademark must have been affixed on the parallel imported goods by the foreign brand owner or its licencee; (ii) the trademark holders (both in the exporting country and in Japan) must be a single party or may be legally or economically considered the same party, so that the mark affixed on the imported goods is deemed to indicate the same origin of goods as the origin indicated by the registered trademark in Japan (i.e., no damage to the origin indication function of the trademark); and (iii) the goods subject to parallel imports and goods bearing the registered trademark in Japan are not noticeably different in terms of quality. The Supreme Court relied on the "function theory" of the trademarks and considered that neither the source function nor quality function is harmed when these three conditions are met.

In this particular case, the owner of the "Fred Perry" brand in Japan claimed damages from the importer of "Fred Perry" polo shirts. The imported goods were produced by a trademark holder in Singapore but the manufacturing of the merchandise was traced to China in breach of a licence agreement. The court determined that the above conditions were not satisfied as violation of the licence agreement impeded a clear indication of the brand's origin and quality. The goods were produced outside of the contractual territory and without supervision from the licensor.

Whenever the imported goods do not meet the quality level of the authentic goods sold in Japan, the import and sale by a parallel importer may amount to trademark infringement. The above principles do not apply exclusively to trademarks. If the quality of the goods is affected during the reconditioning or repackaging process prior to sale in Japan, this may amount to an infringement of the brand's reputation. Rulings on "repackaging" are rare (Tokyo Court of Appeal, 1922, LT Peabel, SNC v. Tamizo Kanazawa, on the bottling of perfume in smaller vials; Osaka District Court, 1976 and 1994: STP Corp. on oil, also decanted, and Magamp K concerning fertiliser).

Patents

Regulations have evolved favourably for parallel importers since the days of the Brunswick Corp. v. Orion Kogyo K.K. case (1969), in which the District Court of Osaka advocated a very rigorous territorial approach to the ownership of patent rights. It refused to apply the patent exhaustion doctrine at international level in order to prohibit parallel imports of bowling material. According to this doctrine, the first unrestricted sale by a patent owner of a patented product exhausts the patent owner’s control over that particular item. The doctrine follows from the premise that a patent owner is entitled to a single royalty payment for each patented product. That is, by selling or authorising sales of the patented products, the patent owner has bargained for, and received, an amount equal to the value of the patent rights that attach to the products. Stated another way, the first authorised sale of a patented product terminates the patent owner’s rights with respect to that product and he should henceforth not be allowed to restrict the resale of those goods.

This doctrine can be applied both on a national and international scale. Nationally, rights will lapse but marketing abroad will not exhaust the patent owners' rights. However, applied internationally, the owners' rights are considered as having fallen away as a result of a sale overseas. In the Brunswick case, after much hesitation, the court chose to apply the Japanese Patent Act and adopted a harsh approach in terms of territoriality and independence of a patent rather than the application of the doctrine at international level.

These principles of independence and territoriality of patents were rapidly perceived as an obstacle to the development of international trade and to the free movement of goods protected by a patent. Consequently, in 1997 the Supreme Court ruled in the BBS Kraftfahrzeugtechnik A.G. v. Racimex Japan K.K. case between BBS, a patent owner in Japan and Europe, and Japanese parallel importers, that parallel imports of vehicle spare parts arriving from Germany did not infringe the patent rights of BBS in Japan. The Court ruled that Article 4-bis of the Paris Convention[3] on the independence of patents did not apply. Whilst the Court did not go as far as to acknowledge the international patent exhaustion doctrine, it made significant progress. It ruled that BBS, having voluntarily marketed its goods, could not invoke any Japanese patent rights against the importer in order to control the resale of the goods. However, the Court considered that patent owners could agree with the initial purchasers that the goods will not be sold in Japan, whilst acknowledging the practical difficulty caused by the need to inform the following successive purchasers, who are not party to the initial agreement, of the existence of geographical restrictions. The restriction has to be expressly stated on the patented goods in order to have binding effect.

[3] "(1) Patents applied for in the various countries of the Union by nationals of countries of the Union shall be independent of patents obtained for the same invention in other countries, whether members of the Union or not."

Future trends

It is clear that parallel importers still have sunny days left to spend in Japan. This remains a grim state of affairs for IP owners and official distributors: remedies are scarce and limited and legally risky to implement. The strategies must be carefully planned out on a case by case basis.

Where Japanese legal concepts have been expressed in the English language, the concepts concerned may not be identical to the concepts described by the equivalent English terminology as they may be interpreted under the laws of other jurisdictions.