

Parallel Imports: Latest Practice and Position of the FAS

May 2018

On 13 February 2018 the Constitutional Court of the Russian Federation (the "**Constitutional Court**") issued Resolution No. 8-P ("**Resolution 8-P**")¹ in relation to an application filed by PAG LLC seeking to have a number of provisions of the RF Civil Code² (the "**Civil Code**") dealing with trademarks declared unconstitutional. PAG LLC (the "**Company**") was challenging the legality of the national principle of exhaustion of exclusive rights to trademarks, enshrined in Art. 1487 of the Civil Code, and the rules enabling original goods that have been imported to Russia without the right holder's consent to be declared infringing goods and destroyed on the basis of a claim brought by the right holder (Art. 1252(4) and Art. 1515(1), (2) & (4) of the Civil Code).

The Company sought recourse in the Constitutional Court in connection with a dispute with Sony Corporation over imports to Russia of a shipment of Sony-branded thermal paper for use in medical devices. The Company had purchased the goods from a distributor in Poland and intended to sell them in Russia under a government contract to supply medical products to healthcare institutions. Sony Corporation initiated legal action in a Russian commercial court to protect its rights, demanding that the goods be seized from the Company and destroyed pursuant to Art. 1515(2) of the Civil Code, and seeking RUB 100,000 in compensation from the Company under Art. 1515(4) of the Civil Code. The Russian commercial courts found in favour of the claimant³.

In Resolution 8-P the Constitutional Court assessed the constitutionality of the disputed provisions of the Civil Code and ruled that the PAG LLC case should be reviewed with account for their implications in terms of constitutional law. On 4 May PAG LLC filed an application with a commercial court seeking that the decision be reviewed on the basis of new circumstances⁴.

This information letter summarises the main findings of the Constitutional Court and the FAS's position regarding Resolution 8-P, and sets out our comments in this regard.

1. POSITION OF THE CONSTITUTIONAL COURT

1.1. Legality of prohibiting parallel imports, and good faith on the part of right holders

The Constitutional Court confirmed that the national principle of exhaustion of exclusive rights to trademarks, enabling a right holder to prevent the parallel import of products to Russia (Art. 1487 of the Civil Code), does not contravene the Russian Constitution, because it does not specify which of the principles of exhaustion of rights is preferable, leaving this question instead to the discretion of the legislators (paragraphs e, f and j of Art. 71 and Art. 74(2) of the Russian

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¹ See <http://doc.ksrf.ru/decision/KSRFDecision315752.pdf>, published on 15 February 2018.

² Civil Code of the Russian Federation: Part One, No. 51-FZ dated 30 November 1994; Part Two, No. 14-FZ dated 26 January 1996; Part Three No. 146-FZ dated 26 November 2001; Part Four, No. 230-FZ dated 18 December 2006.

³ Judgment of the Commercial Court of the Kaliningrad Region of 24 February 2015, Resolution of the Thirteenth Commercial Court of Appeal of 2 July 2015, Resolution of the Intellectual Property Rights Court of 1 December 2015 in case No. A21-7328/2014.

⁴ <http://kad.arbitr.ru/Card/f5cf9aaa-27c2-40ea-9ef4-ed5ca6243eb9>.

Constitution). Accordingly, the rule set out in Art. 1487 of the Civil Code cannot itself be held to be incompatible with constitutional requirements.

That said, the Constitutional Court did note that by virtue of the constitutional principle of maintaining the balance of interests of market participants (Art. 17(3), Art. 19(1) & (2), Art. 55 of the Russian Constitution) the courts must critically assess a right holder's demands for protection of his rights and evaluate whether they are acting in good faith (sec. 5(5) of Resolution 8-P).

A court may deny a right holder protection of his rights or reduce the sanctions imposed on a party in breach (sec. 1(3) of the operative part of Resolution 8-P) if the following two conditions are met:

- (1) The right holder *is not acting in good faith*. As examples of bad faith conduct of a right holder the Constitutional Court cited:
 - a. restrictions on the import of certain goods to Russia; and
 - b. overpricing in the Russian market compared to the prices in other countries, by an amount greater than that which would be characteristic for customary business operations and which would be consistent with the reasonable economic interests of the right holder (sec. 5(7) of the rationale of Resolution 8-P).

The Constitutional Court gives no explanation as to what exactly is meant by "restrictions on the import of certain goods". Following the logic of Resolution 8-P, it could be assumed that the Constitutional Court had in mind an outright ban on the import of a given product or actions aimed at artificially creating a shortage of supply, when a right holder, having prohibited parallel imports, refrains from importing goods to Russia in a quantity sufficient to fully meet the demand.

The Constitutional Court also noted that a right holder's prohibiting of parallel imports on grounds of compliance with anti-Russian sanctions can be deemed bad faith conduct.

- (2) The consequences of the parallel imports may *threaten the lives or health of citizens or other public interests*.

Such a threat, in the opinion of the Constitutional Court, may arise if bad faith conduct on the part of a right holder restricts access by Russian citizens to vitally important goods, such as certain types of drugs or life-support equipment (sec. 5(7) of the rationale of Resolution 8-P).

1.2. Liability of parallel importers

The Constitutional Court ruled that both counterfeit goods and original goods imported into Russia through parallel imports can be deemed infringing goods on the basis of Arts. 1252, 1484, 1487 and 1515 of the Civil Code. Putting infringing goods into circulation is punishable with civil law penalties on the party responsible. However, in keeping with the principles of fairness and observance of the balance of constitutionally significant interests, such penalties must be commensurate with the infringement.

To that end, the Constitutional Court has given the following interpretation of the Civil Code rules on liability for infringement of exclusive rights to

trademarks, as applied to parallel imports (sec. 6 of the rationale of Resolution 8-P):

- (1) Right holders may bring any claims envisaged by the Civil Code for protection of exclusive rights against parallel importers.
- (2) Civil law liability for grey imports cannot be the same as liability for importing counterfeit products. An exception is instances where parallel imports cause the right holder to incur losses comparable to losses from counterfeit goods being put into circulation.
- (3) When determining the amount of compensation for infringement of an exclusive right to a trademark in accordance with Art. 1515(4)(1) of the Civil Code, the courts are to take into account the fact that a right holder's losses from parallel imports are generally less than the losses attributable to counterfeit goods being put into circulation.
- (4) Original products that are found to be infringing goods (i.e. grey imports) may be seized and destroyed pursuant to Art. 1515(2) of the Civil Code only if they are of improper quality or for the purpose of safeguarding and protecting people's lives and public health, the natural environment and items of cultural value.

2. POSITION OF THE FAS

Historically the Federal Antimonopoly Service has advocated introduction of the international principle of exhaustion of exclusive rights in Russia. The international principle of exhaustion of exclusive rights to trademarks envisages that as soon as goods bearing a trademark are put into circulation in a market anywhere in the world by a right holder or with his consent, such right holder cannot prohibit the import of those goods to a particular country, even if they were intended for the market of a different country.

The FAS holds that the national principle of exhaustion of rights leads to a situation where foreign manufacturers can monopolise the import of products to Russia, inflate prices, including prices of socially important goods, and manipulate their assortments to the detriment of consumers' interests⁵. In the opinion of the FAS, refusal by a right holder to allow third-party importers to import products may be indicative of bad faith⁶.

FAS deputy director Andrey Kashevarov stated at a 2017 press conference that the antimonopoly authority believes parallel imports can lawfully be prohibited only in two cases:

- (1) if the importer is seeking to import counterfeit goods; or
- (2) if the right holder has localised the production in Russia of products protected by a trademark⁷.

In other situations, the prohibition of parallel imports, according to the FAS, may be treated as an instance of unfair competition (Art. 14.8 of Federal Law No. 135-FZ On Protection of Competition, dated 26 July 2006 (the "**Competition Law**")).

⁵ This position is set out in a draft FAS Report in the possession of Antitrust Advisory regarding the state of competition in the Russian Federation in 2017. The final draft of the report is to be submitted to the Russian Government by 1 June 2018.

⁶ See, for example, <https://fas.gov.ru/news/6388>.

⁷ See the briefing of FAS deputy director A.B. Kashevarov of 18 July 2017, available at <https://www.youtube.com/watch?v=w5KX4lyHIVo>.

In June 2017 the FAS issued a warning to four right holders not to infringe the antimonopoly legislation (in the form of unfair competition) in connection with the prohibition of parallel imports. In the regulator's view, there were indications of unfair competition in that the companies that were the right holders did not respond for a protracted period of time to requests from third-party importers to supply products to Russia, or would not agree to such imports⁸. In the opinion of the FAS, the fact that the right holders had granted a limited number of dealers the exclusive right to import the products, as a result of which the dealers could sell the goods in Russia at inflated prices, constituted bad faith conduct⁹. The FAS noted that the purpose of such a policy was to increase the profits of the companies involved by limiting competitors' profits and excluding them from the market, which is incompatible with the requirements of integrity, reasonableness and fairness.

At a briefing of the Association of European Businesses on 29 March 2018 FAS director Igor Artemiev confirmed that the regulator's position, outlined above, has not materially changed following the rendering of Resolution 8-P¹⁰. Moreover, in a recently published draft FAS Report on the state of competition in the Russian Federation in 2017¹¹ the FAS reiterated its position that parallel imports should be legalised in the Russian Federation. A working group of the FAS Public Council has now been set up to discuss the legalisation of parallel imports. Based on the group's work, a report setting out how this issue can be resolved is to be submitted to the FAS Public Council.

3. COMMENTS

The interpretation of the rules on liability for infringement of exclusive rights to trademarks set out in Resolution 8-P and the FAS's position on parallel imports give rise to numerous questions as to how right holders can protect their rights with respect to parallel imports.

3.1. Protection of right holders' rights in the wake of Resolution 8-P

Although the Constitutional Court has not prohibited right holders from pursuing civil law remedies for enforcement of their infringed rights, in light of the interpretation of the Civil Code rules given in Resolution 8-P, right holders are advised to take a balanced approach when choosing a method of protecting exclusive rights.

3.1.1. Destruction of grey original goods

Since from the position set out in Resolution 8-P it follows that original goods can be seized and destroyed on the basis of Art. 1515(2) of the Civil Code only in certain cases, right holders should assess whether the unauthorised import of their products to Russia poses a threat to public health or security in general.

Such a claim may be successful in cases where, for example, the use in Russia of goods meant for another market might not be safe due to the fact that they are

⁸ See the FAS warnings issued to YD Diagnostics <http://solutions.fas.gov.ru/ca/upravlenie-kontrolya-reklamy-i-nedobrosovestnoy-konkurentsii/ia-48206-17>, Daimler A.G. <http://solutions.fas.gov.ru/ca/upravlenie-kontrolya-reklamy-i-nedobrosovestnoy-konkurentsii/ia-48304-pr-17>, Renault s.a.s. <http://solutions.fas.gov.ru/ca/upravlenie-kontrolya-reklamy-i-nedobrosovestnoy-konkurentsii/ia-48300-pr-17> and KYB Corporation <http://solutions.fas.gov.ru/ca/upravlenie-kontrolya-reklamy-i-nedobrosovestnoy-konkurentsii/ia-48297-pr-17>.

⁹ Decision of the Commercial Court of the City of Moscow of 13 December 2017 in case No. A40-159212/17-122-1403, reversed by Resolution of the Ninth Commercial Court of Appeal No. 09AP-4958/2018 of 15 March 2018 in connection with the claimant's withdrawal of its claim.

¹⁰ A recording of the Q&A session of the briefing is available at <https://www.facebook.com/rus.fas/videos/1788572731209278/>.

¹¹ <https://fas.gov.ru/documents/626604>

not compliant with Russian technical standards. It would appear that claims seeking the seizure and destruction of products can also be brought if the right holder can prove that the importer is not capable of servicing the products, without which they cannot safely be used.

3.1.2. Compensation

The Civil Code stipulates that instead of damages a right holder can seek a certain amount of compensation from a party that infringes its exclusive right (Art. 1252(3) and Art. 1515(4) of the Civil Code). From a formal standpoint, this remedy does not envisage that the right holder must prove the amount of losses he has incurred. However, in light of the position set out in Resolution 8-P, the assessment of the amount of compensation may now also depend on the proven amount of losses, because when evaluating the amount of compensation to which a right holder is entitled its commensurability with the actual losses incurred must be assessed.

3.1.3. Preventing infringement

Pursuant to Art. 1252(1)(2) and Art. 12 of the Civil Code, a right holder may demand that an infringing party stop infringing an exclusive right by any lawful means (including those not expressly mentioned in the Civil Code). In the context of parallel imports, in our view, a demand to stop an infringement may specifically require that, for example, the goods be removed from Russia or sold to an authorised importer of such goods, or that the infringing party enter into a licence agreement with a right holder on the same terms and conditions as those usually applied in relationships with authorised distributors.

3.2. **Recommendations**

Given the position set out in Resolution 8-P, which while not allowing parallel imports somewhat restricts the ability of right holders to prohibit them, we believe the FAS will continue to pursue its practice of holding right holders who restrict imports of their products to Russia by third-party importers liable for violation of the antimonopoly legislation.

Accordingly, we would advise foreign companies that import goods to Russia (most notably manufacturers of socially important goods such as medicines, medical equipment and life-support goods) to exercise caution when formulating their pricing policy in Russia. Right holders should have a clear understanding of all elements of their product assortment and prices for their goods in Russia and should be able to cite objective reasons to the antimonopoly authority for any difference between the price of their goods on the Russian market and the prices offered by the same right holder in other countries.

When deciding to decline requests of third-party importers to import original products to Russia, the reasoning for the decision should be prepared in advance.

We shall follow further changes in the legislation and regulatory practices with respect to parallel imports, including further developments in the PAG LLC case in connection with Resolution 8-P, and shall keep you updated.

This letter is for informational purposes only and should not be construed to provide recommendations for a specific business situation