DEALING WITH COUNTERFEITS, GREY GOODS AND ME-TOO'S IN THE AUTOMOTIVE INDUSTRY

Counterfeit car parts are sometimes dangerous and very often inferior to the genuine article. Grey goods, although genuine, can undermine local pricing, put margins under unnecessary pressure and upset key accounts. The sale of "Me-too" products, which are substantially identical to the branded product but do not bear the brand, leads to price depression and loss of market share.

In this review, we consider what tier one manufacturers can do about these problems.

Definitions

Counterfeits

Counterfeit goods are "fakes": they bear the trade mark of the branded product but they are not manufactured by the brand owner or with its consent. They compete directly with the brand product - principally in the aftermarket - and are intended by those who make them to be used as a much cheaper substitute for it. Sometimes the purchasers of such products appreciate that they are not the genuine item, but sometimes they do not.

Counterfeits damage the business of the brand owner in a number of ways. Firstly and most obviously, they reduce the brand owner's profits – both because of counterfeit substitution for the branded product and also because the presence of the counterfeit product on the market leads to downward pressure on the pricing of the genuine product. Secondly, and more perniciously, where the purchaser or user of the counterfeit products is not aware that they are counterfeit then the inferior quality, poorer performance and functionality of the counterfeit products - which are unlikely to have been manufactured in accordance with ISO/TS 16949 or with other applicable standards - may undermine the reputation of the branded product.

Grey Goods

Grey goods are genuine products, made by the brand owner or by a third-party with their consent, which were sold into one territory for resale to end users (in that territory) only but which are then re-exported into other markets. Markets in grey goods tend to be strongest where there is a material price differential between different countries. In the automotive sector grey goods tend mainly to be an issue in the aftermarket.

It is no surprise that the products which have historically suffered most from parallel imports are pharmaceuticals – the pricing of which varies considerably depending on local market conditions and, in particular, the prices imposed by state or large corporate providers of healthcare services. However, consolidation amongst both the major car manufacturers and their largest suppliers has increasingly led to a situation where the same engine and the same components are used in numerous different vehicles, sold under different model and brand names in numerous countries, whose local pricing varies considerably. Against this background, it is no surprise that grey goods have become a significant issue for many tier one suppliers in the aftermarket.

Me-too Products

Me-too products are identical to the branded product but do not bear the supplier's branding. The sales proposition behind such products is that they are as good as the well-known supplier's branded product but are very much cheaper. Self-evidently the damage which such products do to the tier one supplier is that they lead to lost sales and downward pricing pressure.

Counterfeits – Developing a Strategy

The first step for the tier one supplier is to ensure that they fully protect the intellectual property rights which subsist in relation to their key products. This will require obtaining registered trade mark and registered design registrations, as well as patents where appropriate. Such registered intellectual property rights will greatly assist in terms of enforcement, as explained more fully below.

The next step for the tier one supplier is to set up a properly functioning reporting system in relation to counterfeits. The tier one supplier's eyes and ears will be its sales force; but that sales force must know to whom they should report details of counterfeit products which they encounter in the market.

Once counterfeit products have been identified, the following are the enforcement options open to the tier one supplier.

Preventing the Goods Entering a National Market

An owner of intellectual property rights such as patents, registered or unregistered designs, registered trademarks or copyright can request HMRC to detain specified goods as they transit through customs into the UK or any other EU member state. If such goods are found by HMRC they will be temporarily detained for a period of up to two weeks and thereafter for longer periods providing that the rights owner commences infringement proceedings in the civil courts relating to such goods or reaches an agreement with the owner of the goods in relation to their abandonment or continued detention.

To notify customs to search for particular goods requires a simple form to be completed. Custom seizures of goods can be an effective first line of defence against counterfeit goods.

Goods on the Market in the UK

1. **Trading Standards**

   Where the counterfeit goods infringe registered trademarks or copyright, the tier one supplier can ask the local Trading Standards Authority to seize the goods and prosecute those who are dealing with them.

   The main advantage of using Trading Standards Authorities is that there is no cost to the brand owner. The downside of using them is that they vary considerably in terms of their experience of and interest in dealing with IP crime. Some of them are also considerably overworked and are unlikely to respond quickly, save in relation to counterfeits likely to endanger life or cause illness.

2. **Civil proceedings for IPR infringement**

   Where goods are clearly counterfeit then the UK courts provide quick remedies, such as injunctions, against those behind the counterfeit trade.

   Considerable care is required, however, in choosing the right targets to sue: obtaining an injunction against a shelf company alone will often amount to a hollow victory. Individual directors and others concerned with the infringement need to be similarly injuncted from dealing in the counterfeit goods again.

   A downside of civil enforcement can be the cost of obtaining the remedies – particularly if the case is defended.

3. **Private criminal prosecution against those manufacturing, importing or dealing in the counterfeit goods**

   This remedy is only available in the UK in relation to counterfeits, which infringe registered trademarks or copyright.

   A major advantage of a private criminal prosecution is that a criminal record and the possibility of losing one's freedom can act as a much greater deterrent to a counterfeiter than a civil injunction or a claim for damages that the counterfeiter often has neither the means to pay.

   Criminal proceedings also often move relatively quickly. In a clear cut case there is a material incentive for the defendant to plead guilty at the earliest available opportunity – doing so can lead to a reduction of up to a third off the sentence which can be imposed upon them.

   Finally, it is worth noting that the private prosecutor will, win or lose, generally recover a significant proportion of his legal costs out of Central Funds – i.e. the taxpayer picks up a substantial proportion of the cost of the private prosecution. This is a material advantage compared to private civil actions, where the situation not infrequently arises that the defendant is ordered to pay the successful right owner's legal costs and damages but simply does not have the funds to do so. There have been numerous cases where corporate defendants have gone into liquidation rather than pay damages and legal costs to a successful claimant.

Grey Goods

To control grey goods it is essential that the tier one supplier has registered trademark protection as such rights are the first – and most effective – line of defence against parallel importers.

In the European Economic Area the position is that the brand owner has the right to control the first marketing of his branded goods within the EEA. The sale of branded products outside the EEA does not amount to consent to the resale of those goods into the EEA market, unless it is clear from all the circumstances the brand owner had given up his rights to object to subsequent re-importation of such goods into the EEA and their sale there.

Consent to subsequent marketing in the EEA can be express or implied. If implied, the circumstances of the sale must be such as to unequivocally establish that the proprietor of the trade mark has renounced any intention to enforce his right to object to the subsequent sale of the goods in the EEA.

In one case, involving Honda motorcycles, the Australian Honda dealer had sold large numbers of motorcycles to a company which he knew to be an exporter/dealer without any attempt to impose any restriction on where such goods could subsequently be resold. Applying the principle from an earlier case that a proved act which is consistent with consent to marketing in the EEA and inconsistent with the absence of such consent unequivocally establishes such consent the court held that the Australian distributor could not have intended to reserve any right to object to the subsequent marketing of the motorcycles in the EEA.

The rule for tier one suppliers is therefore very clear – they need to ensure that their sales teams and distributors use their own approved, pro forma, standard sales contracts, which expressly:

- prohibit their purchasers from re-exporting the goods into the EEA;

[1] The 27 member states of the EU and also Lichtenstein, Iceland, and Norway.

- prohibit their purchasers from selling the goods to anyone who they know or have reason to believe is likely to re-export the goods into the EEA;
- oblige such purchasers to impose like restrictions on any person to whom they sell the products, with such restrictions being enforceable by the tier one supplier (if possible under local law).

Prevention is better than cure in relation to controlling grey goods and it needs to be clearly spelt out to sales teams and distributors that they should only sell product to bona fide regional distributors outside the EEA for local distribution/end use and not to known or suspected reimporters/dealers. Transgressors need to be punished and to be seen to be punished.

Where there are differences in quality or functionality between similarly branded products in different parts of the World then such differences can also support a passing off action, where the imported goods are sold in such a manner as to damage the reputation of the brand owner or his local brands.

Me-too's

What (if anything) can be done in relation to me-too products depends entirely on the extent to which the products which have been copied are still protected by intellectual property rights, such as patents, registered and unregistered designs and copyright.

If products are protected by these rights then such rights can be deployed, via a civil and/or a criminal action, to take such products off the market. Customs seizures and action by local trading standards may also be available options, as set out above. It is for these reasons that a prudent tier one manufacturer should always ensure that its key products are protected by a broad intellectual property portfolio which will last for long enough to keep such products protected during their economic life.

If you would like to informally discuss any of the issues raised in this review then please contact either

Contact

Andrew Clay
Partner, Birmingham
T +44 121 222 3358
E andrew.clay@squiresanders.com

Simon Garbett
Partner, Birmingham
T +44 121 222 3390
E simon.garbett@squiresanders.com