Submissions to the Productivity Commission
Intellectual Property Arrangements – Issues Paper

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Costco is a membership warehouse club dedicated to offering its members a broad range of quality brand-name merchandise at prices consistently lower than are typically found at conventional wholesale or retail sources, as well as private label products under the name "Kirkland Signature". Costco Warehouses are also designed to help small-to-medium-sized businesses reduce costs by providing product for resale and for everyday business use at substantially lower prices.

Costco began operations in Seattle in 1983. As of August 2015 Costco had 686 warehouses globally, including 7 in Australia, and over 81 million cardholders. Its annual revenue for the year ended 31 August 2015 was $116.2 billion. Costco at that time employed 205,000 full and part-time employees worldwide.

An essential element in achieving the best prices for Costco members in Australia is the ability to source genuine, quality, branded goods when and wherever they may be offered for supply at the best prices, whether or not this is through the regular, established supply chains for those goods in Australia or whether those goods are sourced elsewhere (**diverted goods**), particularly outside Australia and parallel imported to Australia.

Costco seeks to form relationships with local authorised suppliers of genuine, quality branded goods wherever possible. Where it obtains diverted goods, Costco takes extensive steps to determine whether the goods it obtains are genuine and are supported by proof of provenance and chain of supply. Naturally, manufacturers and distributors of those goods might be keen to obtain this information. So Costco does not generally make the supply chain details available.

The supply by Costco of diverted goods to Australian businesses and private consumers through its Costco Warehouses provides access to those goods at a significantly reduced price in the knowledge that such goods are supported by Costco's strict supply guidelines, its rigorous supply chain process and its money back guarantee. This is good for Australian consumers and encourages competition within Australia.

The Scope of the Inquiry set out in the Issues Paper states that the Commission should:

> 2. recommend changes to the current system that would improve the overall wellbeing of Australian society, which take account of Australia's international trade obligations, including changes that would:
>
> ….
> (b) allow access to an increased range of quality and value goods and services;
> (c) provide greater certainty to individuals and businesses as to whether they are likely to infringe the intellectual property rights of others

The ability to parallel import diverted, genuine, quality, branded goods at lower prices clearly benefits the Australian consumer within the terms of 2(b) above. Currently however, there are various uncertainties and barriers to the parallel importation process in Australia which clearly is a detriment. The removal of these uncertainties and barriers would further the objective provided for in 2(c) above.

Costco makes submissions in relation to two aspects of the parallel importation of diverted goods, being:

(a) the practice of registering trade marks in various countries in the name of different companies within a corporate group to create barriers to global trade. As a consequence, diverted goods that are parallel imported into Australia infringe the Australian trade mark registration even though the goods are manufactured by the same global corporation and are essentially the same goods. This is clearly contrary to the objectives set forth in 2(b) and (c) above; and

(b) in the event that trade mark registrations are owned by the same company in relevant countries (being the country of manufacture, the country of supply and in Australia), the complex and treacherous application of the defence under section 123 of the *Trade Marks Act 1995* (Cwlth) (**Act**) - that the registered "trade mark" is not infringed if it was applied "by, or with the consent of, the registered owner of the trade mark" – results in an unknowable risk of trade mark infringement. Recent cases have found that confidential contractual provisions between the trade mark owner and manufacturer may negate apparent consent, thereby making otherwise genuine goods infringing goods.

A few examples might assist in explaining these issues:

(a) A handbag brand manufactures its global supply of a particular design of handbag in a single factory in China and distributes its handbags throughout the world including in the US and Australia. The trade mark registrations in Australia are owned by one company within the larger brand company conglomerate while the trade marks in the US are owned by another. The importation of the particular handbag design from the US to Australia will be an infringement of the Australian trade mark. Without knowing the information about the single manufacturing source for the handbags (which is likely to be too costly and perhaps impossible to determine), the defence to infringement under section 123 cannot be relied upon – it is up to the infringer to assert and prove the defence – even though the mark was arguably applied by or with the consent of the Australian trade mark owner (since all handbags are manufactured at a single source for distribution to all countries).

(b) A global trade mark owner grants a licence to the manufacturer of goods under the registered trade mark in India. It is a condition of the confidential license agreement that the manufactured goods bearing the mark be first placed into the market in India. The manufacturer is listed on the global brand owner's website as an authorised manufacturer of goods bearing the mark but the contractual requirement to market the goods first in India is not mentioned. An Australian importer places an order with the manufacturer with the intention of parallel importing the goods into Australia and asks for the goods to be first shipped to Pakistan (a breach of the licence agreement). The trade mark owner sues for infringement of its trade mark in Australia and the trade mark is found not to have been applied with the consent of the trade mark owner due to the breach of contract – a fact that is unknowable by and undisclosed to, the Australian importer. The importation and sale of the goods into Australia is a trade mark infringement even though the owner of the registered mark in all three countries (India, Pakistan and Australia) is the same and the manufacturer was listed as an authorised manufacturer.

Costco engages in an expensive, time consuming and rigorous due diligence process with respect to the trade mark ownership for any diverted goods that are intended to be parallel imported into Australia, including inquiries made in the country of manufacture, the country of supply and in Australia. It assesses whether the goods are of the same or different quality from the goods generally supplied through regular channels in Australia or from other corresponding goods sold under the trade mark elsewhere (since this can indicate a lack of consent to apply the mark for the purposes of Australia). It seeks advice if there is any discrepancy. Given the discounts offered by Costco to its customers, the due diligence cost can make importation of the product unviable.

It is Costco's contention that the two issues listed above (and for which examples are provided) are the result of an unreasonable application of IP law in order to set up barriers to free global trade and to prevent access by Australian consumers to genuine goods at the best price.

There can be no disadvantage to consumers in allowing the parallel importation of diverted genuine goods. Arguments that warranties may not apply on parallel imported goods or that the quality of the goods might be different are and can be addressed in a number of ways (under Australian consumer law, through Costco's money back guarantee and by identification and notification to consumers where goods might be genuine but qualitatively different from the regular product). Such arguments are simply scare tactics and have no merit.

Costco submits in relation to the two issues raised above that action should be taken as follows:

(a) where goods are otherwise genuine goods, prevent companies from artificially creating trade mark infringement by using differentiated ownership of trade marks in different countries. One model to address this issue is contained in section 97A of the *Trade Marks Act 2002* (NZ);

(b) amend the defence to infringement under section 123 of the Act so that it functions as it must surely have been intended - to prevent trade mark owners from preventing the importation, offering for sale and sale of genuine goods - not to allow manufacturers to prevent the importation and sale of diverted parallel imported goods on the basis of an unknowable fact that the importer and seller has the onus to prove.

NB. The issue of consent in particular has been addressed in numerous cases including:

Transport Tyre Sales Pty Ltd v Montana Tyres Rims & Tubes Pty Ltd [1999] FCA 329
Montana Tyres Rims & Tubes Pty Ltd v Transport Tyre Sales Pty Ltd [1998] FCA 708
Sporte Leisure Pty Ltd v Paul's International Pty Ltd (No 3) [2010] FCA 1162
Lonsdale Australia Limited v Paul's Retail Pty Ltd [2012] FCA 584
Paul's Retail Pty Ltd v Lonsdale Australia Limited [2012] FCA 724
Paul's Retail Pty Ltd v Sporte Leisure Pty Ltd [2012] FCAFC 51