C/M/S/ Cameron McKenna

Food & drink bulletin

Current issues in your industry

November 2006

It continues to be a challenging time for the UK food and beverage industry. Manufacturers are under continuing pressure from the media's unrelenting coverage. Brands found to have acted against consumers and shareholders' best interests have suffered financial and reputational damage. These factors are set to continue, alongside new legislation that will affect the industry. We have identified a number of topical issues with comment on how this may affect your business and in certain instances what you need to do.

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In brief, our articles include:

Food contamination
How unsafe does a food have to be before it is withdrawn? How can risk be assessed and how risky is "risky"? We've analysed recent incidents and given guidance to the questions involved in risk assessment.

Enlightened shareholder value
For almost 150 years, directors' duties have been formulated through various court decisions, but now they will be written down. The new Companies Act spells out what directors should have regard to in relation to corporate social responsibility. In theory, directors of food companies are in the same position as the directors of any other company, but directors of public companies in the food sector may feel the pressure first, simply because food itself has such a high profile in the media. Furthermore, it could get personal for the directors concerned!

Supply chain compliance
Food companies and their sales teams are under pressure to achieve targets, commit to low prices and gain market share. The temptation to do deals with retailers which conflict with competition laws has never been greater. We have highlighted some of the dangers, from pricing issues, to stocking and exclusivity arrangements and category management.

Spirits advertising: Poland goes for a ban
In the current climate of public and government concern over binge drinking will self-regulation be enough or will the threat of a ban on advertising be realised? Poland is about to ban spirits advertising – what will that mean in practice? Could it happen here?

Parallel imports and trade mark infringement
The Court of Appeal may have given some encouragement to parallel importers in the battle between them and brand owners over the legitimate interests of the former and the free trade principles of the latter. Whatever the issues, brand owners probably have no choice but to press on with their enforcement campaigns.

We hope you find these articles of interest and we would be happy to discuss the issues raised further with you.

Louise Wallace - Head of Consumer Products
louise.wallace@cms-cmck.com

"Food companies and their sales teams are under pressure to achieve targets, commit to low prices and gain market share."

Zero tolerance for contamination?

Who would want to be a risk manager in the food industry nowadays? The recent Cadbury's "million-bar product recall" shows that where public health is concerned a zero tolerance threshold may well be the best policy. However, in food, as in life, there is no such thing as zero risk.

"In practice, much greater attention is given to hazards that may be injurious to health as compared to those that simply affect the fitness for consumption of a food such as mouldiness or other quality defects."

"The Microbiological Safety of Food (ACMSF), with the benefit of hindsight, has since concluded there should be a 'zero' tolerance level for salmonella in ready-to-eat foods."

Increased sensitivity in testing means that there may now be a whole host of undesirable and/or "unsafe" contaminants newly identified in our foods, but in such tiny quantities that they may be unlikely to have any ill effect. Where does your company stand on the risk management issues involved?

The key decisive factor to consider in any risk management is the safety of human health.

The main European Food Regulation 178/2002 sets out the law on when a Food Business must carry out a withdrawal and recall and when to notify the competent authorities. This is when a Food Business Operator considers or has reason to believe a food is in breach of the 'Food Safety Requirements', namely, if the food is either "unsafe" meaning it may be injurious to health, or it is unfit for human consumption. In either scenario, on a literal reading of the Regulation, it must be withdrawn from supply and the relevant competent authorities notified. Recall, however, should be a last resort where other measures are not sufficient to achieve a high level of health protection.

In practice, much greater attention is given to hazards that may be injurious to health as compared to those that simply affect the fitness for consumption of a food such as mould or other quality defects.

Cadbury's recall

In June 2006 Cadbury announced it was recalling seven brands in Britain. They were linked to a salmonella outbreak affecting 37 people. The company had earlier discovered some quantities of the montevideo strain of the bacteria in its products after a leaking pipe dripped contaminated water onto a production conveyor belt of chocolate crumb base.

There has been media outcry over Cadbury's not notifying the authorities sooner than it did and having to take this recall action. The delay was reportedly caused by Cadbury's risk assessment process. Prior to the reported outbreaks occurring Cadbury's had looked carefully at the available data on the level of amounts of salmonella that had caused previous outbreaks. They then made a risk management decision that, based on the low amount of the salmonella bacteria detected, the risk of any adverse event from the contamination did not require any withdrawal or recall action.

After the Food Standards Agency (FSA) was informed of the situation this decision was scrutinised. Specialist Salmonella Contact Group of the independent Advisory Committee on the Microbiological Safety of Food (ACMSF), with the benefit of hindsight, has since concluded there should be a "zero" tolerance level for salmonella in ready-to-eat foods.

This might be said to indicate an expectation by regulators and consumers of absolutely no naturally occurring bacteria that may cause ill health in ready-to-eat foods, even if they appear at levels that are (based on historical data) unlikely to have any physiological impact.

Other high profile food incidents

Recent incidents such as: the contamination by illegal colourings Para Red and Sudan 1 in early 2005, the ITX (Isopropylthioxanthone) contamination in baby food in November 2005, and contamination of US rice with an unauthorised GM variety reported in August 2006 illustrate that expectations of safety are not necessarily consistent, and there is still room for risk-based decision making in cases of food contamination.

Para Red and Sudan 1

The European Food Safety Authority (EFSA) was introduced to provide risk assessment information in a clear and transparent form to inform both the EU Parliament and the risk management of member states and food business operators. The EFSA supported the evidence that the illegal colours were possible genotoxic carcinogens but there was insufficient information to carry out a full risk assessment. Some Member States found that extremely small levels of contamination posed such a low risk that no recall or withdrawal was necessary. The UK FSA's position was a blanket recall of all contaminated food, without a threshold de minimis level.

ITX in baby food

In November 2005 it was reported there was contamination at very low levels in some liquid infant formula products of the industrial chemical ITX, a component of printing inks used on some food packaging. In this instance, the EFSA considered the chemical in relation to the amounts found in the food product and concluded there was no immediate health risk. Based on this the FSA concluded no withdrawal or recall was necessary.

GM rice contamination

Most recently contamination has been found in long grain US rice by an unauthorised GM strain. Despite it being stated there was insufficient information available for the EFSA to produce a full risk assessment, it was found that the contamination was not likely to pose an imminent safety concern to humans or animals on the basis of toxicological, molecular and compositional data. Preliminary reports from US rice producers indicated the level of adventitious presence of the GM rice might be below the labelling threshold level of 0.1% (Riceland reported 0.06% i.e. 6 in 10,000 seeds). However exposure levels in the EU Members States could not be estimated accurately from the data provided. The FSA have considered no withdrawal or recall is necessary and that it would not be proportionate for retailers to track down and remove all products from sale that contained the genetically modified rice. The FSA then updated their advice reminding retailers that the GM material is illegal and that it was retailers' responsibility to ensure that the food they sell complies with the law. Any rice known to be contaminated with GM material was illegal and should be removed from sale. This seems to contradict the FSA's own initial position on proportionality and their response on ITX in baby food and goes further than the food safety requirements, possibly as a result of pressure from consumer and environmental organisations.

Conclusion

In the case of contamination a risk assessment should always look carefully at the potential hazard. If there are even the slightest safety concerns one needs to tread very carefully. The burden of proof, in practice, is on producers to establish that the risk of this hazard occurring is, if not non-existent, then so low as to be statistically insignificant. However, as the recent history has shown, evidence of risk is open to much interpretation. It must be anticipated that the "Precautionary Principle" could be asserted by regulators to justify action to err on the side of caution if there is any scientific uncertainty.

"Other recent high profile incidents are not necessarily consistent and there is still room for risk-based decision making in cases of food contamination."

Risk assessment in the food industry should also take into account consumer confidence and brand reputation as well as hazard and the likelihood of the hazard occurring in this highly risk averse and sensitive industry.

Jessica Burt
jessica.burt@cms-cmck.com

Risk assessment guidelines for food products

Helpful questions to ask in any risk assessment. It is recommended that all food business operators regularly practise crisis management.

Background facts

- What is the lifespan of the food? In what quantity is it consumed?
- Who is it targeted at?
- Which managers hold Hazard Analysis Critical Control Point (HACCP), due diligence, quality testing and hygiene records, regulatory files, instructions, warnings, information on customer complaints etc?
- How much of the food is in circulation?
- What batches are affected?

Assessing the risk of the hazard

- What is the hazard?
- What causes the hazard?
- Does the hazard only occur in certain situations that may be defined?
- Are the particular health sensitivities of a specific category of consumers affected? Is the food intended for that category of consumers?
- How serious are the consequences, eg is there the possibility of the food being injurious to health?
- Are there any probable immediate and/or short-term and/or long-term effects of that food on the health of a person consuming it, but also on subsequent generations? Are there any probable cumulative toxic effects?
- If not unsafe in normal circumstances, is the food unacceptable for human consumption?
- How predictable is the hazard?
- Is the hazard avoidable? What steps are possible or feasible to avoid it occurring?

In case of difficulty, it may be helpful to consider the following question in addition to those listed above:

- What, if anything, is the general and approved practice in this situation?
- What is the attitude of the regulatory authorities/FSA/EFSA?
- Do competitor foods have the same hazard or how do they avoid it?
- How damaging would the disclosure of the company's existing records on the problem appear if no action is taken?

Enlightened shareholder value: anxious directors

The new Companies Act is a wide-ranging reform of the core legislation which governs every significant UK business entity. One of the most significant changes introduces the concept of 'enlightened shareholder value', thereby reflecting social change in the last 15 years. These provisions are likely to come into force in October 2008.

"Chapter 2 of Part 10 of the Act contains the controversial new directors' duties. For the first time, the duties of directors will be written down in the statute "

The all encompassing concept of corporate social responsibility will now no longer be entirely elusive and abstract. Instead, directors will have new duties and obligations in this respect. If the many high profile "social" issues which face the food industry, such as provenance, ethical trading, local sourcing, obesity and supplier relationships, will mean that directors of companies within the food sector will be particularly affected by the so-called "enlightened shareholder value" concept. At present, however, directors are more apprehensive than enlightened by the prospective changes.

Chapter 2 of Part 10 of the Act contains the controversial new directors' duties. The very fact that the Act contains anything at all on this area is itself controversial. For the first time, the duties of directors will be written down in the statute book. Codification will supersede the general fiduciary duties which have been formulated through the British courts ever since the first Companies Act in 1862. So, the general common law duties for directors – to act bona fide and in the best interests of the company; not to make personal profit; not to put themselves in a position of conflict – are to disappear, replaced by seven sections of the Companies Act.

A new key section will be Section 173, which reads as follows:

173 Duty to promote the success of the company
A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to –
(a) the likely consequences of any decision in the long term,
(b) the interests of the company's employees,
(c) the need to foster the company's business relationships with suppliers, customers and others;
(d) the impact of the company's operations on the community and the environment,
(e) the desirability of the company maintaining a reputation for high standards of business conduct, and
(f) the need to act fairly as between members of the company.

It is the importance and significance attached to the wider ranging factors in (a) to (f) above (CSR Factors) that has fuelled the debate during the latter stages of the Bill. Whereas the common law fiduciary duties which have preceded the codified duties are general and therefore somewhat nebulous, and certainly flexible, these codified duties and the CSR Factors are to be written in tablets of stone.

What does this mean for directors in the food sector?
Any company that is involved in manufacturing, sourcing or selling a product or its ingredients in the food chain knows the importance of fostering the company's business relationships with suppliers and customers; the impact of the company's operations on the community and the environment and the desirability of a reputation for high standards of business conduct. These and many other aspects contribute to "success" in any case; but it is one thing for directors to achieve or seek to achieve success for their investors in the way they choose using their business judgement, and quite another for directors to have legal duties and obligations to "have regard" to

the CSR Factors. Breach of the legal duty means a director can be sued personally. The success of a company will now mean more than just maximising profits.

Directors of companies in the food sector are only too aware of the importance to their business of the CSR Factors. It is easily arguable that they drive business value, but they definitely feature in any risk management exercise. At the very least, the costs of getting it badly wrong are enormous (one only has to consider what organisations such as Nike or Chiquita have had to do to change their public perception of a few years ago). The uncovering of one major incident or alleged unethical strategy can have an effect which is both instant and measurable for investors in the company.

The enshrining of the enlightened shareholder value provisions in Section 173 of the new Companies Act is not the only reason for directors to be more concerned about their personal liability. There are changes in the new Act which make them easier litigation targets for a wider group of people.

Directors owe their duties to the company itself. Historically, case law has governed how and when companies are able to bring so-called derivative actions against their own directors – and they have been complex and uncertain. Nobody could advise with particular certainty when and where such a claim could be made.

Part 11 of the new Companies Act introduces a new process for bringing derivative actions. Although there will be safeguards against unwarranted or frivolous claims, directors should be concerned about how the process will be operated. The existence of a new special process means that somebody is likely to exploit it. Just at the time that activist shareholder groups are honing and developing their techniques to gain maximum influence, a new derivative claims process can be exploited to test the range of these new and specific directors' duties which are enshrining the so-called enlightened shareholder value. Directors beware.

More specifically, any member can bring the derivative claims. They do not even have to be members at the time of the alleged breach of duty. The claim can be in respect of not only an actual, but also a proposed, act or omission constituting negligence or breach of the directors' duties – therefore an unethical course of conduct or implementation of a particular unethical sales strategy might make the directors vulnerable.

Quite apart from this new threat of personal liability for a director, single issue activists can cause great reputational damage to companies. The new Act will contain significant barriers aimed at preventing undeserving claims. In particular, before any such action is launched, the court will need to be convinced that the claimants have a prima facie case (on risk of cost or other sanctions). The court will also take into account the evidence of interests and views of the silent majority of shareholders (or allow the company to gauge it).

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So what effect will all these changes have on the corporate governance of companies in the food sector?

During the course of the Companies Bill, the opposition consistently expressed concern that directors' business judgment made in good faith could be second guessed as a result of these enshrined shareholder value provisions. Furthermore, to head off this concern there would need to be a paper trail to demonstrate directors' "regard" for the CSR Factors.

Whilst the Government has been making light of these concerns, it was also warding off other organisations such as the Trade Justice Movement, Christian Aid and War on Want, which sought a stronger and more direct form of duty on directors to take into account the CSR Factors.

If a private company became insolvent due to, for instance, a contaminated product scandal, the liquidator might scrutinise the company's governance to assess the "regard" that the directors had for the relevant CSR Factors. But it is listed public companies and their directors who will be most affected. The vast majority, if not all, UK public listed companies will feel that it is motherhood and apple pie that they must have regard to all the CSR Factors in order to be successful. As from October 2008, however, the directors may be personally liable if they have not.

As a result, public companies in the food sector may look to align and supplement their existing procedures so as to match the CSR Factors expressed in Section 173(1) of the new Act. We may see the emergence of the "Community and Environment" committee, the "Business Relationship" committee and the like.

Somebody is going to try out the new system. Food companies, never far from the public gaze, and very accessible to the consumer by the nature of their products, will be in the firing line if their products feature in the next food or environmental scandal. And this time it could get personal for the directors, especially if shareholder value is affected.

Martin Mendelssohn
martin.mendelssohn@cms-cmck.com

"As a result, public companies in the food sector may look to align and supplement their existing procedures so as to match the CSR Factors expressed in Section 173(1) of the new Act. We may see the emergence of the 'Community and Environment' committee, the 'Business Relationship' committee and the like."

Supply chain compliance: sales team beware

For food and drink manufacturers, competition law compliance is particularly important in their dealings with retailers. Failure to observe the competition rules can expose you to lengthy and costly investigations by the competition authorities, fines of up to 10% of turnover, actions for damages by aggrieved third parties, as well as unwelcome publicity.

Account managers and sales teams are under significant pressure to achieve internal financial targets, to supply the products at low prices to achieve the retailers' desired margins and to achieve market share growth in an increasingly competitive environment. Arrangements made with retailers in these tough commercial conditions can often come into conflict with the competition rules. The areas in which competition concerns frequently arise are identified below.

Pricing issues

All retailers must be completely free to set their own prices as they wish. It is legitimate to recommend a retail price and even in some cases stipulate a maximum price. However specifying a minimum retail price, a fixed retail price or enforcing a recommended retail price using any direct or indirect pressure, incentives or threats will constitute a serious infringement of the competition rules.

Although these rules seem clear, this is an area that frequently gives rise to concern on the part of sales teams and account managers when negotiating with retailers. Common examples of areas of difficulty include:

Price marked packs – the difficulty in providing packs with the price permanently marked on the packaging is that the manufacturer is effectively specifying a fixed resale price. The pre-printed price gives rise to an expectation on the part of the consumer that the product will cost the same as that marked on the pack and the retailer has little or no flexibility in deviating from this. To avoid an infringement, in all cases, the retailer should be offered the option of taking exactly the same product in packaging that has not been price marked, without incurring any disadvantage in doing so. Alternatively, it should be clearly stated on the packaging that the marked price is only a recommended retail price.

Promotions – these take many forms, often incorporating discounts and rebates. It is important to ensure that, although the promotion may only be short-lived, it is never possible, subject to the ability to set a maximum price, to infringe the principle that the retailer should be free to set its own price. For example, rebates, discounts or special wholesale price offers used to encourage a retailer to run a promotion should not be contingent on the retailer selling the product at a fixed price or never going below a minimum price.

Margin estimates and guarantees – frequently and particularly at times when a manufacturer is seeking a price increase, retailers request an indication from manufacturers on the relevant margins that could be achieved. Estimated margins can be provided based on an assumption that your product is sold at RRP. However, any margin should be clearly stated to be an estimate. It should never be expressed as being guaranteed, fixed or a 'target' margin.

Discounts and rebates – sales teams should be aware of two basic rules when granting discounts and rebates: (i) not to use them as a means to ensure adherence to a fixed or minimum resale price and (ii) to ensure that they cannot be considered abusive if they relate to a product which is dominant.

Resale prices are dealt with above. As for dominance issues, then there is nothing wrong with a dominant market share (40%+) but having a dominant position does impose special responsibilities. A dominant company must not profit from its dominance to the detriment of consumers or competing manufacturers with smaller market shares.

There are fundamentally three types of discount: discounts based on volume, discounts based on targets and so-called fidelity or loyalty discounts. Of these three, volume discounts are the least likely to infringe the prohibition on abuse of a dominant position provided that the discount or rebate is given to the customer because of the objectively justifiable and quantifiable amount the customers buys and is referable to cost savings.

Discounts or rebates granted as a reward for reaching defined targets may also be an abuse, particularly if the criteria are not transparent and the reference period over which the discounts are calculated is long.

A fidelity or loyalty rebate is usually granted as a reward for exclusivity and will often oblige the customer to take all or most of its purchases from one source. The commercial justification for the customer doing so is unlikely to be objective and cost-based and these are therefore likely to be considered as abusive.

To avoid further competition law concerns, any discounts which relate to dominant products should not be set at a level that the resulting price of the products could be predatory (i.e. below costs). Neither should they be discriminatory in the sense that equivalent discounts should be granted to equivalent customers.

Frequently, discount or rebate schemes can apply to a bundle of products, some of which are dominant, others not. Thus any scheme in which dominant products are present should be carefully scrutinised. As a general rule, any discount, rebate or even exclusivity arrangements that relate to a dominant product should be agreed separately, distinct from other product schemes.

Stocking and exclusivity arrangements

With the pressure on available shelf space ever increasing, manufacturers frequently seek a variety of ways to ensure their products are stocked in place of those of their competitors. Arrangements include:

Shelf space commitments and incentives – it is permissible for you to agree with and/or incentivise retailers to increase your share of space on fixtures. However, concerns can arise where your market share exceeds 40%. European Commission guidance indicates that your share of shelf should not exceed your relevant market share of the product concerned.

Product ranges – various incentives and arrangements may be used to ensure that the retailer stocks a number of products across a product range. Such incentives can be particularly problematic if they relate to any product that is dominant. Making the stocking of a dominant product conditional upon the purchase of another product or range of products is likely to constitute an abuse of a dominant position. This is also likely to arise where a discount or rebate is granted which is conditional on the stocking of other products of the supplier or is conditional on the retailer reaching set purchase thresholds or stocking a specified percentage of a product. Obliging a retailer (with or without a discount) to stock the full product range is also likely to constitute an abuse.

Exclusive supply agreements – In general, exclusivity is likely to be problematic only where the products concerned are dominant. In such cases, outlet exclusivity arrangements are likely to give rise to material competition concerns and should be avoided. Similar concerns will also arise in relation to exclusive arrangements relating

"Whilst it is legitimate to recommend a retail price and even in some cases stipulate a maximum price, specifying a minimum retail price, a fixed retail price or enforcing a recommended retail price using any direct or indirect pressure, incentives or threats will constitute a serious infringement of the competition rules"

to the use of a freezer, refrigerator or cooler unit where the retailer is not permitted to use the unit for any competing products. Indeed, on 28 September 2006, the European Court of Justice upheld a decision of the Court of First Instance that it was contrary to EC competition law for Unilever's subsidiary Van den Bergh Foods (formerly HB Ice-Cream) to supply retailers with freezer cabinets on the basis that these cabinets be used only to stock HB impulse ice creams.

Category management

Manufacturers are frequently invited to participate in category management initiatives by retailers where they are asked for their recommendations on the product range for the category and other related matters. This can raise two concerns: (i) it may facilitate the exchange or disclosure of commercially sensitive information between competing manufacturers and (ii) where a manufacturer is appointed a category manager and is dominant, undue pressure placed on the retailer may be found to be abusive behaviour.

Participation itself does not give rise to any competition concerns but it should be carefully monitored. The relationship should be between the manufacturer and the retailer only. The disclosure of commercially sensitive information should be limited. Certainly no such information should be exchanged between manufacturers, and the retailer should be restricted from providing any information it receives from one manufacturer to another. Above all, category management should not be used as a forum for manufacturers to agree between themselves as to the appropriate listings or placements within a category.

Conclusion

The above issues are just some of the typical areas in which food and drink manufacturers can face competition concerns in their day-to-day dealings with retailers.

The size of many sales teams and the commercial pressures they face can mean that many of these issues are overlooked.

It is therefore critical to ensure that you have an effective compliance policy in place with regular training of all necessary personnel and with access to clear and practical manuals and guidelines. Whilst such a policy helps to ensure that you avoid any competition law infringements, the very existence can be used by the competition authorities to reduce any eventual fine should an infringement ever be investigated.

Caroline Hobson
caroline.hobson@cms-cmck.com

"It is critical to ensure that you have an effective compliance policy in place with regular training of all necessary personnel and with access to clear and practical manuals and guidelines."

Poland: total ban on spirits advertising in the pipeline

In the current climate of public and government concern over binge drinking will self-regulation be enough or will the threat of a ban on advertising be realised? This issue is relevant across Europe and is currently being debated in Poland.

"Both OFCOM (broadcast media only) and the Advertising Standards Authority (ASA), the self-regulatory advertising bodies in the UK, have recently changed their rules to try to enforce a more responsible culture of alcohol advertising."

"Distributors of alcoholic beverages on the Polish market carry out very creative marketing campaigns to promote their products, and use all available gaps in the law."

Position in the UK

Advertising of alcoholic products has been a hot topic in the UK over the past couple of years, especially with under age drinking in the UK constantly seen to be rising with socially detrimental effects. Both OFCOM (broadcast media only) and the Advertising Standards Authority (ASA), the self-regulatory advertising bodies in the UK, have recently changed their rules to try to enforce a more responsible culture of alcohol advertising.

Under the new OFCOM rules, factual information about an alcoholic drink's contents may be given but advertisers cannot make any type of health, fitness or weight control claim. The CAP Codes, which are enforced by the ASA, restricts suggestions that alcohol has therapeutic qualities and prohibits any suggestion that alcohol can be linked to social success and sexual prowess. The changes were particularly aimed at strengthening the protection towards the under-18s. The ASA has been seen to take a hard line with advertisers who have not complied with the new rules. We expect the ASA will continue to do so.

Snapshot of the CEE markets in alcoholic beverages

As in the case of "old" EU Member States, the rules on advertising alcoholic beverages in the CEE countries differ from one state to another. In Hungary and the Czech Republic it is possible to advertise all alcohol provided that such ads do not appeal to minors, encourage excessive consumption, or suggest therapeutic benefits. They usually cannot be broadcast in prime time on radio or television, nor can they be published on the front or back covers of printed materials. In the Russian Federation, advertising rules are more restrictive in respect of spirits and more lax towards beers (the latter can be advertised on radio and TV whereas the former cannot).

In Poland, the rules on advertising alcohol are more severe, as compared to the other CEE countries. Currently, it is prohibited to publicly advertise any alcoholic beverages except beer, save for when such advertising or promotion takes place in so-called permitted areas, i.e. in on-trade, alcoholic beverages sections in supermarkets, or shops where only alcohol is sold. It is worth mentioning that the very definition of alcohol advertising is very broad in scope and encompasses a public display of trademarks of alcoholic beverages or graphic symbols related to them in order to make them more popular; trade information addressed to retailers or restaurateurs falls outside the scope of that definition.

Sanctions for breaching the ban are harsh: apart from fines of up to approx. EUR 125,000, a distributor (importer or domestic producer) in breach may face losing the wholesale license for up to three years. However, it is true that the enforcement of the law in question leaves a lot to be desired. Distributors of alcoholic beverages on the Polish market carry out very creative marketing campaigns to promote their products, and use all available gaps in the law. The law dates back to the 1980s, when martial law was introduced in Poland, and has been amended many times since. This has left it inconsistent in many areas, and leaves much room for "creative" interpretation. Many distributors openly act on the borderline between what is prohibited and what is

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permitted, thus frustrating those whose corporate rules prevent them from acting within grey areas.

Absolute ban on spirits advertising to be introduced in Poland

The Polish Ministry of Health has proposed an amendment to existing rules on advertising alcoholic beverages that will completely outlaw any spirits advertising. There will be no more "permitted areas" where alcohol advertising has been possible so far. The amendment is thought to protect minors from being exposed to alcohol advertisements in places like supermarkets or on-trade outlets. The government is expected to send the draft new bill to parliament soon, with a request for its adoption. Public consultations regarding the new proposed regulations have not yet ended. The National Board of Spirits Manufacturers is collecting legal and business ammunition against the draft bill, but it has not been very active in contesting it so far.

What are the practical implications of the new rules?

The introduction of the new law will mean lots of changes in conducting business for the whole spirits industry, as well as for retailers and restaurateurs. All POS materials bearing trademarks of alcoholic beverages (leaflets, posters, etc.) will have to disappear from both on-trade and off-trade. Hostesses encouraging tasting various alcohols in shops, clubs or pubs, will no longer be allowed. Pub and club owners will have to get rid of so-called permanent branding, i.e. all permanent decorations which bear trademarks or symbols of alcoholic beverages. It will be interesting to know who will pay for this redecoration: on-trade or brand owners. No longer will it be possible to organise contests in pubs or shops where alcohol is a prize. Added value packs containing a bottle of alcohol and a gift will also be problematic.

What will be allowed then?

All marketing activities that are not public, i.e. not addressed to an unspecified audience. Examples of such activities include direct mailing of marketing materials to people from the distributors' database, preferably to those who consented to or even requested such mailing. Also receptions organised by alcohol distributors that can be attended by invitation only, aimed at promoting a particular brand, will be outside the prohibition due to their non-public character.

The restrictions in question will make it more difficult for the spirits industry to communicate with consumers. There are voices that the total ban on spirits advertising will be incompliant with the free movement of goods principle, on the basis of the new restriction being disproportionate to the aim pursued, i.e. protection of health and life of humans. Anyhow, some of these restrictions seem nonsensical in the era of the Internet and satellite television. If they are to be enforced with such little vigour as the law currently in force, this will only cause confusion on the market and a dangerous inflation of law.

Malgorzata Surdek
malgorzata.surdek@cms-cmck.com

"The Polish Ministry of Health has proposed an amendment to existing rules on advertising alcoholic beverages that will completely outlaw any spirits advertising. There will be no more 'permitted areas' where alcohol advertising has been possible so far."

Cracking the code: parallel imports and trade mark infringement

What happens when trademark rights and competition law collide? In a recent case in the Court of Appeal (Sportswear SpA v Stonestyle Limited) the Court of Appeal had to balance and consider the conflicting interests of brand owners and parallel traders.

"Brand owners must ensure that the desirability and premium image which surrounds their products is not diminished by the sale of inferior quality branded goods intended for overseas markets, and counterfeit items, which can constitute a risk to consumer health or safety."

The case considered the application of two fundamental (and potentially conflicting) legal principles:

- First, under trade mark law, in an exception to the principle of free movement of goods across the European Economic Area (EEA), trade mark owners can object to parallel imports where the condition of the goods has been impaired or changed after they have been put on the market.
- Second, under competition law, no company may enter into an agreement which may affect, or have as their purpose, the prevention, restriction or distortion of competition with the EEA.

Supply chain management

Brand owners must ensure that the desirability and premium image which surrounds their products is not diminished by the sale of inferior quality branded goods intended for overseas markets, and counterfeit items, which can constitute a risk to consumer health or safety.

To ensure control over the supply chain, many branded goods reach consumers through exclusive distribution arrangements in one or more of the various member states. In return for exclusivity in their applicable territories, distributors are restricted from onward sale to the "grey market" where goods are exported/imported between EEA states to take advantage of higher prices in more lucrative western European markets.

As well as strict measures of quality control and exclusive distribution arrangements, many brand owners invest in supply chain management technology to "track and trace" the movement of genuine goods within the market. This technology helps to identify counterfeits so that they can be traced and eliminated from the market.

However, a common allegation made by parallel traders is that an additional aim of such arrangements is to restrict and police the onward sale of goods to the grey market from their distributors.

Objections to importation

In **Sportswear**, the brand owner was the manufacturer of clothing branded with STONE ISLAND. Distribution of the brand owner's goods in the UK was by an exclusive UK distributor, who was prevented from any onward sale to the parallel trade market.

The defendants in **Stone Island** also sold genuine STONE ISLAND goods in the UK, which had been purchased from authorised distributors. However, it was likely those distributors were in breach of their contract with the brand owner.

In order to prevent the brand owner identifying the source of their goods, the parallel importer had removed or defaced labelling and swing tags from the clothing which

contained codes that would have enabled the proprietor to identify the source of those goods, and presumably cut off supply by enforcing the terms of the relevant distribution arrangements.

The brand owner sued for trade mark infringement, claiming that the "mutilation" of the goods by the removal and defacement of the codes and tags was damaging the brand's reputation, and that their importation should be prevented.

In return, the importer claimed that the real motivation of the proceedings was to enforce territorial exclusivity and to discover the source of supply to prevent further parallel imports. In its defence, the importer claimed that the restrictions on sale imposed on the brand's distributors were unlawful and anti-competitive.

Court of Appeal judgment

The brand owner obtained summary judgment by arguing that since there was not a sufficient link between the distribution agreements related to the source of the importer's goods and the allegations of trade mark infringement, there was no arguable defence.

The Court of Appeal disagreed and held that there was an arguable defence under competition law. The intention of the distribution arrangements was a clear geographical separation for the products and prevent the distributors from selling into any other territories. It was at least arguable that if the restrictions on onward sale were in breach of competition law, the brand owner would not have a legitimate reason to complain of trademark infringement.

Finely balanced competition

Many organisations have been surprised by the Court of Appeal's finding of an arguable defence in this case since it had been considered that the "Euro-defence" was something of a last ditch hope by importers to avoid trade mark infringement.

There are also significant public policy concerns if brand owners are discouraged from taking steps intended to assist with the identification of counterfeits, many of which raise public health and safety issues by failing to comply with necessary regulatory standards.

Parallel importers may well be emboldened at the possibility that potential breaches of competition law in distribution arrangements could constitute a defence to trade mark infringement. It is unlikely, however, that brand owners will be deterred from their IP enforcement programs at this stage. As always, the law (and policy behind it) must be finely balanced between the legitimate interests of a brand owner to ensure the quality and consistency of goods across their supply chain, and those importers who seek to rely on the principles of free trade to take advantage of price differentials across the EEA.

Tom Scourfield
tom.scourfield@cms-cmck.com

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For further information on any of the topics covered in this bulletin, please contact your client partner or alternatively Louise Wallace on +44 (0)20 7367 2181

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CMS Cameron McKenna
Mitre House
160 Aldersgate Street
London EC1A 4DD

T: +44 (0)20 7367 3000
F: +44 (0)20 7367 2000