GLOBAL LEGAL GUIDE

FOR

LUXURY & FASHION

COMPANIES

Baker & McKenzie

Baker & McKenzie's Global Legal Guide for Luxury & Fashion Companies

Preface

At the start of my career as a lawyer in the fashion world, in the 1990s, there was no formalized “fashion law” bar or treatise addressing legal issues in the fashion and luxury industries. It is a common misconception that intellectual property is the central focus for the fashion and luxury industries; however, my daily life in-house also involves labor and employment, real estate, advertising and social media, finance and global tax issues, agency laws, customs and trade issues, antitrust, compliance, and licensing and distribution, all very much integral parts of fashion.

In my positions as an in-house lawyer at Calvin Klein Jeanswear Company and WestPoint Stevens Inc., and the first general counsel – and, in fact, first lawyer – of the popular brands Kate Spade, 7 for All Mankind, and Stuart Weitzman, I developed an understanding of the unique legal and business problems that fashion houses faced, and I have become well versed in the legal concerns of the retail world. Baker & McKenzie assisted me in addressing these matters for each of the fashion companies at which I worked. Its European, North and Latin American, EMEA and Asian offices were the architects of the trademark prosecution and enforcement programs at Calvin Klein Jeanswear Company, and it has globally represented, in diverse matters, the various companies I have worked for. It is, indeed, the go-to global law firm for many luxury and fashion companies.

It was the void in resources that led me to put together the first handbook in fashion law, *Fashion Law: A Guide for Designers, Fashion Executives, and Attorneys*, now in its second edition. This book led to me teaching the much-needed fashion law courses at Benjamin N. Cardozo School of Law and New York University School of Law, and guest lecturing on fashion law at Harvard Law School, the University of Chicago Law School, University of California, Hastings College of Law, and many other law schools throughout the United States and the rest of the world. As a lawyer and professor, I understand the importance of expanding the literature and information in this growing field of the law, and I applaud Baker & McKenzie’s efforts in providing practitioners with a resource that did not exist when I first began my practice. Just as other fields of the law have libraries of texts relating to their practices, luxury and fashion, with its evolving and demanding issues, deserves its own growing collection. What better firm than Baker & McKenzie, with practices spanning the globe, to compile Baker & McKenzie’s *Global Legal Guide for Luxury and Fashion Companies* - a guide to all fashion and luxury related issues in this industry.

The *Guide* is unique in its global approach not only to the cutting issues of the law but its insights into trends in the industry. Contemporary issues such as competition, government and supply chain compliance, international tax, alternative dispute resolution, and digital and online services are only a few of the topics tackled here. Mergers and acquisitions of fashion companies have been a growing trend; I have lived through six such mergers in my career, and Baker & McKenzie has vast experience representing fashion clients in the purchase and sale of companies. The growth of online retailing and social media, the challenge of fast fashion and instant copying, the fact that even the smallest start-up brand is instantly a global company dealing with country-specific corporate, employment and tax laws, have all demonstrated the importance of a Legal Guide like this and the relevance of Baker & McKenzie. I recommend this *Guide* to all leaders in the fashion industry.

Barbara Kolsun, Esquire

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Foreword

The global luxury market has been expanding steadily, reaching an impressive US$254 billion in 2014. From yachts, wines and hotels, to perfume, jewelry and clothing, demand for quality and exclusivity has significantly contributed to the growth of the luxury and fashion industry. Not only is the sale of luxury and fashion goods expanding geographically, it has also been spreading across the world, due to the increase in touristic spending. As a result, the number of consumers in this industry has more than trebled in the past 20 years.

Currently, 35 percent of the global luxury market will be captured by Chinese consumers. Those same consumers made 110 million overseas trips in 2014. Annual revenue of China's two largest and most popular e-commerce marketplaces, Taobao and Tmall, is over US$250 billion, far more than eBay (US$16 billion) and Amazon (US$75 billion) combined. Pair this with the growth of an innovative, trendsetting fashion and cosmetics scene in Korea, the continued influence of Japan, and the expansion of the middle class across Southeast Asia, and it is clear that a new era has arrived in Asia: that of a newly mobile, sophisticated generation of consumers attuned to the dynamic trends of global luxury and fashion. These staggering figures should not diminish the already steady and vibrant growth experienced by this industry in Europe, the Americas and the Middle East.

On a firm level, Baker & McKenzie has assisted a number of the world's largest luxury and fashion companies to launch their strategies throughout the world. Our 40 years of experience reflect our goal to provide truly global legal services, manifested in our commitment to bring together over 300 partners worldwide into the firm's Luxury and Fashion Industry Practice Group. This practice group began its evolution upon its launch in 2012, with a series of seminars, workshops and breakfast briefings in New York, Paris, Milan and Hong Kong. These events continued in 2013 and 2014, including a gala event at our annual partners' meeting in London in October 2014, and more events are planned throughout the world in 2015.

The Baker & McKenzie *Global Legal Guide for Luxury & Fashion Companies* was a natural outgrowth of these efforts, seeking to provide our clients with a comprehensive reference point for the contemporary, cutting-edge issues facing the industry. In this guide, you can tune into "playlists" for identifying, registering and enforcing intellectual property rights – in Chapter 1, an overview by country of new challenges on the horizon for enforcing those rights against infringement; and in Chapters 2 to 5, exploring what it takes for luxury and fashion companies to thrive in the 21st century, across a breadth of issues, including IP planning, social media, online sales and alternative distribution models. Chapter 6 explores the ever-changing tax and transfer pricing environment surrounding the industry, Chapter 7 addresses the basics in merger and acquisition transactions, and Chapter 8 focuses on the growing concerns for government compliance, as with Foreign Corrupt Practices Act issues. Chapter 9 explores negotiating leases for shop-n-shops, counters and flagship stores; Chapter 10 addresses techniques for resolving disputes through litigation, arbitration and mediation; Chapter 11 focuses on various employment concerns; and Chapter 12 provides an analysis of customs and trade issues for global brands.

Lastly, Chapter 13 identifies competition and antitrust issues, which are often forgotten or overlooked.

While we cannot provide an exhaustive analysis of all facets of the global luxury and fashion industry, we hope that you find this guide a useful practical reference for questions that you may have about this fascinating and constantly changing industry. Over 225 lawyers and economists from our firm have contributed to the *Global Legal Guide for Luxury & Fashion Companies*, and, as Co-Chairs of this Practice group, we thank them all, as well as our steering committee, which includes Stephane Davin, Lorenzo de Martinis, Laurent Barbara and John Fabbro. A special thanks is also extended to the 10 Practice Group Chairs who championed the chapters in this Guide, as well as our fully engaged and committed business development team, including Laurie Robertson, Tis Dias, Paul Baumeister, Emily Porter, Patricia Alexis Dominguez, Anniebelle Valle, John Lau and Anand Ramaswamy. Without their dedication and passion, this guide could not have been realised.

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Chapter 1: Identifying, Registering, Enforcing and Monetizing Your Intellectual Property Assets[1]

Fashion and intellectual property (IP) have always been inextricably linked in some way. For as fashion emanates from an individual's creativity and vision, IP – in the form of copyrights, trademarks/service marks, trade dress, industrial designs and utility and design patents – provides the legal framework to protect such innovations and creativity, and to encourage people to create unique offerings and enjoy a degree of protection over such creations. Throughout the world, IP laws aim to protect the original and unique creations of designers or inventors and the brands under which these products are sold. Laws protecting such rights were originally introduced in an effort to spur creativity – for who would innovate or create if the thing or article could be quickly copied or a confusingly similar brand or name be used without repercussions, and without compensation to the person who actually had the artistic vision, invested the time and effort in the creative process to translate such a vision into tangible form, and rallied the resources and took the necessary steps to build and develop a reputation and goodwill in a brand for his or her creations, which consumers would recognize and associate with the designer or the company?

Exclusive rights in inventions, creative works, designs and brands are afforded to the owners of those forms of IP by virtue of various international treaties and national laws governing the protection, registration and enforcement of IP. However, each form of IP must meet certain requirements in order to qualify as a patent, copyright, a trademark/service mark or a protectable design. When it comes to the fashion and luxury industry, the nature of IP protection available and scope of enforcement of those rights can vary greatly. For example, the different types of IP available to protect the host of creative elements in an article could include:

- repeating patterns;
- designs on fabrics;
- the overall design of the article;
- the cut and shape of an article;
- the color of articles (in whole or in part);
- innovative design elements, such as zippers;
- ornamentation; and
- specially designed or technical fabrics.

Designers may resort to these tools either alternatively or cumulatively, depending on the goal they are trying to achieve and the scope of protection they seek for their creations. In their search for the best protection, designers will have to consider whether they want to benefit from registered or unregistered IP rights, whether they want to protect the appearance of the product

[1] Lisa W. Rosaya of the New York office is the principal author and editor of this chapter. Ms. Rosaya gratefully acknowledges the assistance of other offices. Those specifically involved in preparing this chapter are Bernard Malone and Maria Paula Bassi, Argentina; Elisabeth White and Jonathan Flintoft, Australia; Flavia Vasconcelos, Flavia Rebello and Thais Carvalho, Brazil; Stephanie Vaccari, Tania D'Souza-Culora, Essien Udokang and Alexandra Lewis, Canada; Andrew Sim, China; Virginie Ulmann and Frederique Fontaine, EU; Virginie Ulmann and Frederique Fontaine, France; Rembert Niebel and Frederike Kerl, Germany; Maria Smith, Hong Kong; Lorenzo de Martinis, Camilla Caravati and Lorenza Mosna, Italy; Ken Takase, Junko Tochigi and Daisuke Tatsuno, Japan; Luis Alcaraz-Vazquez Mellado, Mexico; Eugene Arievich, Russia; Cristina Duch, Anna Guix and Ariadna Suriol, Spain; and Rachel Wilkinson-Duffy, UK.

because of its ornamental qualities, its function of identification, certain technical features, etc. Beyond the scope of IP protection, designers will also want to prevent competitors from unfairly using their investments, reputation and know-how.

Moreover, a company should weigh the benefits one form of protection may have over another. For example, trademarks can potentially last forever (assuming they are still in use), but patents and copyrights will eventually expire. Also, in certain jurisdictions, registration authorities do not conduct a substantive examination of the validity of designs (such as Registered Community Designs in the EU) or design patents; therefore, these forms of protection may be viewed as a weaker form of IP protection from an enforcement perspective.

In this chapter, we will first discuss the general concepts of the different forms of IP, including copyrights, trademarks (including trade dress), service marks, patents, designs, domain names and trade secrets, the scope of protection owners of these types of IP enjoy and the relevance of each form of protection in the fashion and luxury space. We will then explore how certain of these rights can be registered and how long such rights can be protected. Next, we will provide a brief overview as to how IP owners can enforce these rights. (Chapter 2 will provide a more detailed analysis of specific ways to enforce IP assets.) Lastly, we will touch on basic considerations in relation to monetizing IP assets through licensing arrangements.

In light of the global nature of the fashion and luxury goods industry, throughout this chapter we will provide a general overview of these issues and highlight relevant details and anomalies in key jurisdictions. Moreover, in the **appendix** to this chapter, we provide “playlists” summarizing best tips and practices for identifying, registering, and enforcing your company’s copyrights, trademarks and patents.

I. Why IP Assets are Important

A significant degree of resources must be invested in order to create IP. The time and costs associated with the invention, creative and branding processes cannot be underestimated. Building and developing IP requires an assembled trained workforce, as well as a culture that nurtures and encourages creativity, and regular and extensive advertising programs to build the goodwill of the brands. Once created, IP generates customer loyalty and adds to the commercial value of the organization via profits realized from the exploitation of the IP assets – either directly by the company or through commercial agreements or arrangements between the company and third parties.

As IP assets are usually the crown jewels of a company, we provide below an overview defining and providing examples of each type of IP.

II. Types of IP

Generally speaking, there are three main areas of IP: copyrights, trademarks/service marks and patents. In addition to, or sometimes within the scope of, these three areas of IP, protection may be afforded to certain creations that are utilitarian or artistic in nature, or in the case of a design as a whole, the overall look and feel of the design. Moreover, a company may own domain names as well as trade secrets. These assets are commonly categorized under the IP umbrella. We discuss below the details of each of these forms of IP.

A. Copyrights

1. What is it?

Copyright protects original works of authorship, such as writings, music, and works of art that have been tangibly expressed by the author. Copyright exists automatically at the time of creation.

Definition

In the United States, a copyright is defined as an *original work of authorship* fixed in any tangible medium of expression, now known or later developed, from which it can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. This definition generally applies to what is protectable under copyright in other jurisdictions as well.

2. What does it cover?

Copyright protects:

- literary works, such as written content in catalogs, on websites, in advertisements, etc.;
- musical works;
- dramatic works;
- pantomimes and choreographic works;
- pictorial, graphic and sculptural works, such as lace designs, fabric prints, design sketches, engravings, photographs;
- motion pictures and other audiovisual works;
- sound recordings; and
- architectural works.

3. What doesn't it cover?

Copyright does not protect ideas, facts, systems, methods of operation, titles, names, short phrases, slogans, familiar symbols or designs, mere variations of typographic ornamentation, lettering, coloring or works that lack a sufficient degree of originality. Additionally, copyright does not protect objects having an intrinsic utilitarian function that is not merely to portray the appearance of the article or to convey information – there are referred to as "useful articles".

Applied art/ornamental Decoration (copyright, patent and/or design right protection may be available)

In the fashion and luxury space, the cut or shape of garments, accessories and furniture (all of which are generally categorized as useful articles) will not be protected by copyright. However, certain useful articles may contain features that may qualify for copyright (and even patent) protection. For example, if the article has some form of applied art (*i.e.*, design and decoration applied to everyday objects to make them aesthetically pleasing) or ornamental quality, and this portion of the work can be identified separately and exist independently from the utilitarian aspects of the article, it can qualify as sufficiently "original" for copyright protection. For example, in the U.S., copyrights have been registered for ornamental decorations on belt buckles and watch faces.

While this concept of applied art applies in most jurisdictions, the threshold for the requisite level of originality or artistic creation may vary greatly. For example, in **Germany** historically the threshold for copyright protection was higher for works of applied art than for other works. However, in 2013, the German Federal Court of Justice held that works of applied art no longer require a special level of creativity to be protected under copyright law, but are protected under the same requirements as other creative works. This decision significantly strengthens the legal protection available in relation to works of applied art.

Do you need to register to obtain rights?

Generally, the answer to this question is no. This is particularly true in relation to countries that are signatories to the Berne Convention for the Protection of Literary and Artistic Works,[2] which as of writing has 168 contracting parties. The Berne Convention is an international treaty that addresses the rights of authors and protection of copyrighted works. The three basic principles of the Berne Convention are:

- works that originate in one contracting state must be afforded the same protection as works originating from nationals in each of the other contracting states;
- protection is automatic and cannot be conditional upon any formal requirements; and
- protection is independent of any protection that exists in the country of origin of the work.

While copyright generally exists upon creation of a work, registration of a copyright (where available) has certain advantages. For example, in the **U.S.**, before an infringement suit may be filed, registration is necessary for works of U.S. origin and, in order to be eligible for statutory damages and attorney's fees, a work, irrespective of origin, must be registered. If registration occurs within five years of publication, the registration serves as *prima facie* evidence of the validity of the copyright and the facts stated in the registration. In **Canada**, registration is not required; however, it serves as *prima facie* evidence that copyright exists and that the person who registered the copyright is the owner. In **Argentina**, Argentine works must be registered with the National Copyright Office; otherwise, third parties may freely copy or otherwise use the work, provided it is not altered and contains an attribution to the author.

As noted above, while registration is not required, it is recommended in jurisdictions that provide the ability to register works, as the costs are usually *de minimus* and the benefits to the copyright owner can be significant.

What rights does it confer upon the owner?

Copyright provides the owner with a "bundle" of exclusive rights, such as to:

- reproduce the work;
- prepare derivative works;
- distribute copies or phonorecords of the work to the public; and
- perform or display the work publicly.

[2] *Berne Convention for the Protection of Literary and Artistic Works*, 9 September 1886, as revised at Paris on 24 July 1971 and amended in 1979, S. Treaty Doc. No. 99-27 (1986).

A few caveats and twists regarding the ownership of copyrighted works are relevant here.

Work For Hire Doctrine

In the U.S., the "work for hire" doctrine delineates nine specific instances where the owner of a work is not the actual creator of the work, but, rather, the employer of, or entity contracting with, the creator. A work is considered a "work for hire" if it is:

- prepared by an *employee* within the scope of his or her employment (*e.g.*, employees tasked with creating jewelry designs, fabric designs, etc.) or
- specially ordered or commissioned for use as a *contribution to a collective work*, as a *part of a motion picture or other audiovisual work*, as a *translation*, as a *supplementary work*, as a *compilation*, as an *instructional text*, as a *test*, as *answer material for a test*, or as an *atlas*, if the parties expressly agree in a written instrument signed by them that the work shall be considered a work made for hire. (17 U.S.C. § 101)

When considering whether or not a work falls into one of these nine categories, keep in mind that independent contractors or freelancers are not employees. A common misconception is that having an agreement stating a work is a work for hire means it is a work for hire: this is not necessarily true. Unless the work qualifies as one of the nine types of works above, it cannot be a work for hire.

In the case of the fashion and luxury industry, works or articles created by non-employees (*e.g.*, designers and consultants) generally would not fit neatly into any of the nine statutory categories. Therefore, in order to ensure your company owns the works these third parties are creating for you, ensure that a written agreement between the parties specifies that the deliverable is a work for hire and, if the work does not qualify as a work for hire, then the third party assigns all right, title and interest in the work to your company. The assignment clause acts as a bootstrapping measure in the event the work falls outside the scope of the nine statutory categories covered by the work for hire doctrine.

In **Russia**, there is a concept similar to the work for hire doctrine noted above. With respect to designs and other copyrightable works created under employment contracts, the exclusive right to such works are by default vested in the employer. If the employer does not begin use of a work, does not transfer the exclusive right to it to another person, or does not inform the author (employee) of the decision to keep the work secret within three years from the day the employee's work was put at the employer's disposal, the exclusive right to the employee's work will belong to the author.

Moral Rights/Rights of Attribution

Moral rights generally refer to an author's rights to attribution and maintaining the integrity of his or her works. In certain jurisdictions, such as **Argentina**, **France**, **Mexico** and the **U.S.** (to a very limited degree with respect to visual art works), these moral rights effectively mean that the creator of a work can never be severed from his or her creation – he or she always has some degree of control as to how his or her work is used or will be displayed. Moreover, certain jurisdictions – in particular, **France**, do not allow an author to waive or assign his or her moral rights to a third party. Therefore, even if such rights in a work are assigned to your company, or your contract with the author contains a waiver of his or her moral rights, this will not be enforceable in countries that prohibit such a transfer or waiver.

In **France**, French copyright law grants the author economic and moral rights, thus conferring designers full control over their creations. Economic rights include the rights to reproduce, represent, adapt and market the protected work. The exercise of any of these rights without authorization of the author amounts to copyright infringement. Moral rights includes the right of the author to choose to divulge his or her work to the public, to be identified as the author of the work, to oppose any distortion or modification of the work, or to withdraw a work previously disclosed to the public.

Finally, the issue of copyright ownership in the context of litigation must be addressed. Indeed, normally, the plaintiff must demonstrate that it owns the copyrights on the work for which it claimed infringement, either because it has created it, or because the copyrights have been regularly assigned to it.

However, in order to facilitate copyright infringement proceedings, French courts have developed a presumption of ownership theory, pursuant to which when a person exploits a protected work under his or her name, he or she is presumed to own the copyrights on such work. Such a presumption is rebuttable and the defendant will have to produce evidence to the contrary.

B. Industrial Designs/Designs

Industrial designs or, more generally, designs are closely tied to both copyrights and patents. A significant number of countries (see examples below) provide protection mechanisms for these types of designs.

What are industrial designs and designs, must they be registered to be protected and what rights are conferred on owners of such designs?

The definitions of, and protection afforded to, industrial designs and designs vary from country to country, but novelty/and distinctiveness of the design are usually required originality elements. Below, are details of certain key jurisdictions in this regard, including examples of protectable designs that are specific to the luxury and fashion industry.

Argentina

Industrial models and designs refer to the shapes or configuration of elements given or applied to an industrial product that is substantially decorative or ornamental. To be eligible for protection, industrial designs must comply with all ornamentation, novelty and industrial requirements and must not be forbidden by law.

The law provides for the renewal and transfer of industrial designs, cancellation actions, and civil and criminal actions arising from infringement of the owner’s rights.

Australia

A design comprises the visual features of shape, configuration, pattern or ornamentation applicable to a product. Design protection cannot be obtained for the feel of, or materials used in, a product. The visual features of a design applied to a fashion article or to a luxury item, if they are new and distinctive, can be registered.

The following visual features of fashion and luxury items can be registered as designs:

- ornaments or patterns applied to fabrics, leather or to other materials;

- three-dimensional visual features applied to products;
- two-dimensional and three-dimensional visual features applied to packaging; and
- visual features applied to the design of a store layout.

A design registration will generally include a statement of newness and distinctiveness identifying particular visual features of the design claimed to be new and distinctive. The features identified in the statement are given particular consideration in an assessment of whether a design is substantially similar in overall impression to another design and, therefore, a determination of whether the design is distinctive or has been infringed.

Design registrations have a number of limitations. Exclusive rights are only granted to designs that are new and distinctive, and registrations are limited to a relatively short period of time and are not renewable. As a practical matter, it is still very difficult to ascertain what would constitute a design that is substantially similar in overall impression to a registered design. This means that designers face a difficult choice between having to register all variations of their designs, even if they are small, which can be very expensive, or not registering them all and therefore risking not having sufficient rights to cover all potential instances of copying.

Brazil

Industrial designs are the two-dimensional representation (ornamental assembly of lines and colors) or three-dimensional object (ornamental plastic form) that may be applied to a product, affording a new and original look to its external configuration, and may be used for industrial production.

To the extent that a fashion creation complies with such novelty and originality requirements, it is subject to protection as an industrial design. An industrial design registration gives the owner of the industrial design the right to exclude others from manufacturing, marketing, using or selling products violating such industrial design in the country without the owner's prior authorization.

Canada

Industrial designs are "features of shape, configuration, pattern or ornament and any combination of those features that, in a finished article, appeal to and are judged solely by the eye".[3] The key is that the design must be applied to a finished article and cannot exist in the abstract. Examples may include the shape of a perfume bottle, the shape and ornament of a handbag, the shape of a pair of pants, or the pattern on a necktie. Industrial designs do not protect the utilitarian features of an article, a method of manufacturing or construction, materials used in construction, or ideas.

Unlike copyright and trademarks, industrial designs must be registered. To be eligible for registration, the design must be original, in that it must not closely resemble or be identical to a design that has already been registered. The originality requirement for industrial designs is said to be somewhere between the originality required for copyright (low threshold) and the novelty required for patents (high threshold). A slight change of outline or configuration, or an unsubstantial variation, will not suffice.

[3] *Industrial Design Act*, RSC, 1985 c. I-9, s. 2.

European Union

Community designs are regulated by Regulation (EC) No. 6/2002 of 12 December 2001, and these designs protect the outward appearance of whole or part of a product, resulting from its lines, contours, colors, shape, texture or materials.

The European Community legislation provides for design protection either through registration or through use:

- protection as a *registered design* is obtained through the filing and registration of the design with the Office for Harmonization in the Internal Market (OHIM) or an international design registration claiming protection for the European Union (EU) territory; and
- protection as an *unregistered design* is obtained through the first publication or other use of the design within the EU.

Community designs are protected and enforceable in all EU member states.

To benefit from protection, both registered and unregistered designs must satisfy the conditions of novelty and individual character. Design protection is not granted to designs whose characteristics are exclusively imposed by the technical function of the product. Novelty exists if no identical design or design whose features differ only in insignificant details has been made available to the public prior to the date of filing of the application for registration. A design is made available to the public if it is published or used in a product, exhibited or disclosed in such a way that, in the normal course of business, these events could reasonably have become known to the sector concerned, operating within the EU. There are exclusions to prior publication, notably publication by the designer within the 12-month "grace period" preceding the application date.

A design has individual character if the overall impression it gives an informed user departs from the overall impression produced on such user by any design that has been made available to the public prior to the date of filing of the application. Analysis of the individual character takes into account the freedom of the designer in the creation of the design, and, more precisely, the technical requirements utilized by the designer in developing the product. Indeed, the less the designer is technically restricted in creating a design, the more strictly the individual character requirement will be appreciated. In this respect, in a case involving a watch created by Bell & Ross, the Court of First Instance of the EU ruled that, given the high degree of liberty enjoyed by designers in the watch-making industry, watches should depart sufficiently from prior designs to be deemed as having sufficient individual character to benefit from design protection. In this case, Bell & Ross was denied design protection for its aviation-inspired watch (T-80/10, 25 April 2013).

Designs may also be protected under copyright law, depending on whether cumulative protection is granted by the applicable law of each member state and whether the designs meet the national requirements for copyright protection.

France

In France, designs are used to protect the external appearance of whole or part of a product, resulting from its lines, contours, colors, shape, texture or materials.

To benefit from design protection in France, fashion designers can choose between national protection or protection within the EU. To be eligible for protection, designs must be registered with the competent office, *i.e.*, the French Industrial Property Office (INPI) for national designs and the Office for Harmonization in the Internal Market (OHIM) for Community designs. France does not afford design protection for unregistered designs; however, Community unregistered designs are recognized and validly enforceable in France, provided that they meet the validity requirements set forth by EU Regulation n° 06/2002 on Community designs, but their protection is weaker than that of registered designs, both in terms of scope and duration (see the 'European Union' section, above).

To be validly registered, designs must be new and have individual character.

The conditions required to benefit from copyright and design protection are supposed to be distinct; *i.e.*, originality for the former, and novelty and individual character for the latter. In practice, the absence of a prior similar design will be used to demonstrate both the novelty of the design and the originality of the work. Therefore, although copyright and registered designs pursue different purposes, their conditions for protection tend to be appreciated in a similar manner by French courts.

Design registrations provide owners with an exclusive right over the design, including the right to manufacture, offer, market, import, export, use or detain the product incorporating the design. The exercise of any of these rights without authorization of the owner amounts to design infringement.

The scope of protection is not limited to identical designs and covers any design that does not give a different overall impression to an informed observer. The scope of protection is further defined by the degree of freedom of the designer in making the design. Indeed, the less the designer is technically restricted in creating a design, the more he or she will be expected to depart from prior creations in order to avoid design infringement.

Germany

In Germany, protection can be obtained for either registered or unregistered designs. The appearance of the whole or a part of a product can gain protection either under a national design registered with the German Patent and Trademark Office (DPMA) or by a Community Design. A German national design, as well as a Community Design, grants the owner the exclusive right to use the design and to exclude others from using it.

Design protection is granted for the two- or three-dimensional appearances of a product resulting from the features of, in particular, the lines, contours, colors, shape, texture or materials of a product or its ornamentation, provided that the appearance is "new" and has an "individual character". A design is new if no identical design has been made available to the public before the date of filing of the application for registration. A design has individual character if the overall impression it produces on the informed user differs from the overall impression produced on such a user by any design which has been made available to the public prior to the date of filing the application for registration.

Moreover, a design is still considered new and with individual character if it has been made public for the first time within 12 months before the filing, by the designer, his or her successor in title, or a third person as a result of information provided, or action taken, by the designer or his or her successor in title. If a design has been published earlier than the 12-month window such that novelty is lacking, consider filing a trademark application covering the two- or three-dimensional appearance of the pattern.

Italy

The Italian Code of Industrial Property (Legislative Decree No. 30 of 10 February 2005, (ICIP)) governs protection afforded to designs.

Designs are commonly used to protect the external shape of a product, as well as its appearance as it results from the colors, surface or decoration of the materials used. Under the ICIP, designs are recognized as valid forms of protection exclusively if they are locally registered with the Italian Patent and Trademark Office (IPTO). Unregistered designs are not protectable under the ICIP; however, European unregistered (and registered) designs are also recognized and validly enforceable in Italy, provided they meet the validity requirements set forth by EU Regulation No. 6/2002 on Community Designs.

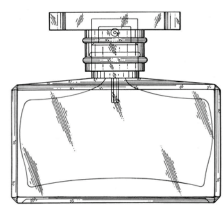
To be eligible for registration, a design has to be new and have individual character, meaning that the overall impression produced by the design on the informed user must differ from the overall impression produced by any design previously made available to the public. The appearance of a product, or part of a product, as resulting from its lines, contours, colors, shape, surface or materials, may be registered as a design, provided that the validity requirements are met (ICIP, section 31). Components of complex products (*e.g.*, buttons, buckles, clasps, etc.) are eligible for registration only if they remain visible during normal use by the consumer, and if the visible features of the component fulfill the above validity requirements. Design protection is not afforded to structural or utilitarian features.

Japan

Design registrations are available for designs that are novel. In order to avoid designs being rejected due to lack of novelty, design protection should ideally be sought before publication, although there is a six-month grace period during which prior publication within that time will not be considered to destroy novelty.

Applied arts may be capable of being registered as design registrations. Examples of registered designs relating to the fashion industry in Japan include:



Mexico

Industrial designs in Mexico include:

- *Industrial blueprints* – any combination of shapes, lines or colors incorporated in an industrial product for ornamentation purposes and that give it a specific appearance of its own; and
- *Industrial models* – any three-dimensional shape that serves as a model or pattern for the manufacture of an industrial product, giving it a special appearance that does not involve any technical effects.

Applications for the registration of industrial designs must include a graphic or photographic reproduction of the design, and an indication of the type of product for which the design will be used.

Russia

Under Russian patent law, fashion designs may be granted patent protection as registered industrial designs, provided they are new and original in their essential features. The essential features of an industrial design include features determining the esthetic and/or ergonomic characteristics of the outward appearance of a fashion product, including shape configuration, ornamentation, and combination of colors. The scope of patent protection of an industrial design is defined by images and/or drawings, along with essential features characterizing the design's appearance. An industrial design is deemed to be used in a product if the product contains all the essential features of the industrial design set forth in the drawings and provided in the list of essential features of the claimed design.

As of 1 October 2014, when amendments to the Russian Civil Code in its IP-related part come into force, the Russian design protection system will shift towards the EU model, in that more emphasis will be put on the visual appearance of the claimed design, rather than on its description.

Spain

Spanish industrial designs, regulated by Law 20/2003, of 7 July, on the Legal Protection of Industrial Designs, protect the outward appearance of the whole or part of a product (*e.g.*, the design of jewelry, a perfume bottle, luxury ornamentation, bags, shoes, or any other luxury item) to the extent that it is new and has individual character. An industrial design constitutes the ornamental or visual aspect of a fashion item and may consist of three-dimensional features, such as the shape or surface of an article, a handbag, or a perfume bottle, or of two-dimensional features, such as patterns, stamping, lines, or colours designed for a brand.

No protection is afforded to unregistered national designs.

Spanish design law confers on its owner the exclusive right to use the work and to prevent any third party not having the owner's consent from using it.

UK

Unregistered design rights may subsist automatically and registered design rights may be obtained through registration. There is, however, a difference in what can be protected under these different rights.

Registered Design Requirements

For a design to be registrable, it must be both novel and have individual character.

In the context of registration, a design is the appearance of the whole or a part of a product resulting from the features of, in particular, the lies, contours, colors, shape, texture or materials of the product or its ornamentation. It should be noted that this definition of a design is broader than the scope afforded under an unregistered design right. In particular, surface decoration such as a repeating pattern can be protected as a registered design, but not under an unregistered design right. Surface decoration may, in many instances, also be sufficiently distinctive for trademark registration, which is likely to provide a stronger right for enforcement purposes.

Unregistered Design Requirements

Originality is a requirement for an unregistered design right and is defined as not being commonplace in the design field in question at the time of its creation.

An unregistered design is any aspect of the shape or configuration (whether internal or external) of the whole or part of an article, but does not include:

i. a method or principle of construction;
ii. features of shape or configuration of an article that "must fit" or "must match"; or
iii. surface decoration.

An unregistered design right will only subsist if the design has been recorded in a design document or an article has been made according to the design.

C. Trademarks and Service Marks

1. What are they and what do they cover?

Trademarks and service marks are a way for consumers to identify the source of a product or service, and attribute a certain level of quality to the good or service they are purchasing. These valuable IP assets protect the owner's investment in goodwill and reputation attached to the mark, protect consumers from confusion or deception as to the source of goods or services purchased, and signify that all goods and services sold or provided under the mark are of an equal level of quality.

Definitions

Traditional Trademarks and Service Marks: Trademarks or service marks are words, phrases, symbols, and/or designs (including signatures), or any combination thereof, used to identify and distinguish the products or services of one party from those of another, and to indicate the source of those products or services. (For the purposes of this chapter, we will generally refer to trademarks and service marks collectively as "trademarks" or "marks".)

Non-Traditional Trademarks: In addition to the traditional trademarks noted above, trademarks can be the appearance of product designs (*e.g.*, "all-over" designs, handles, hinges, buttons, edging, etc.), and product packaging and designs used in connection with the offering of retail services, such as store designs, perfume bottles, handbag designs, etc. This type of right is referred to as "trade dress" in the U.S., "get up" in the U.K. and "distinguishing guise" in Canada.

Some examples of registered trade dress in the U.S. are shown below. Additional examples include Gucci's interlocking GG logo, Louis Vuitton's Toile pattern, Crocs' 3D trademark registration for the shape of its shoe, and Adidas' three-stripe pattern.



Other non-traditional marks include holograms and marks consisting of sounds, colors, flavors, scents, three-dimensional shapes, moving images, tastes and textures. One of the disadvantages of non-traditional trademarks is that these marks are likely to face distinctiveness objections and, in most cases, would require evidence of use, and even evidence of acquired distinctiveness, before they can be registered. For example, in the U.S. a product design can never be inherently distinctive and an applicant must prove acquired distinctiveness in order to register the design. Product packaging can be inherently distinctive, provided it meets certain criteria.

While non-traditional trademarks cannot be registered in every country, more and more countries are permitting registration of at least certain types of these marks. For example, **Canada** is implementing changes to its trademark law in the next year that will allow for registration of an increasing number of non-traditional marks, such as those mentioned above.

2. What can and can't be registered?

Generally, any of the traditional and non-traditional marks mentioned above can be registered and used, provided they are:

- distinctive, non-functional and serve as an indicator of source;
- not confusingly similar to a third party's mark[4]; and
- not deceptive, offensive, scandalous or disparaging.

With respect to *distinctiveness*, whether a mark can be registered and the level of protection afforded to the mark generally directly correlate with the "strength of the mark". Below is a list of elements of a mark, categorized from the strongest to the weakest:

- *Coined/fanciful or arbitrary elements* are, respectively, made-up words with no meaning, or words that have a meaning but not in relation to the goods or services of interest. These elements are usually considered the strongest portion of a mark and deserving of the highest scope of protection from infringement. *Examples: Volcom or Nike for clothing and footwear; Rag & Bone for clothing*.

[4] The Trademark Offices in certain jurisdictions, such as the U.S., Australia, Canada, China, Korea and Mexico, conduct substantive examinations of the register, and will refuse registration based upon prior applications or registrations for marks that are confusingly similar to the applied-for mark. In other jurisdictions, such as the EU, the U.K. and Singapore, the examination phase does not include a review of third-party registrations or applications.

- *Suggestive elements* imply certain attributes of the particular goods or services. These elements are somewhat strong but the scope of protection will largely depend upon the degree the term is used by third parties in relation to similar goods or services. The more widespread such use is, the weaker the element will be from an enforcement perspective. *Example: Downhill for ski wear; Relax for clothing*.
- *Descriptive (also referred to in some countries as non-distinctive) elements* merely describe a purpose, characteristic, quality, user, ingredient, feature or function of the goods or services, and also generally include geographic names and surnames. These elements enjoy only a narrow degree of protection; however, descriptive elements can be protected and enforced if the owner can show that the mark has "acquired distinctiveness" – *i.e.*, due to the substantially exclusive, widespread and/or longstanding use of the mark, consumers have come to recognize the owner as the unique source of that particular product or service. *Examples: American Wear for clothing, McDonald's for fast-food restaurants (acquired distinctiveness)*.
- *Generic elements* of a trademark consist of the apt or common name for the relevant goods or services. These elements are not protectable, as the public has a right to use the generic term to refer to the actual product or service. *Examples: 'leather' for products made of leather, 'jeans' for jeans*.

Additionally, if the trademark fails to function as a source indicator, *e.g.*, it consists of merely informational matter, is the title of a single creative work or is for trade dress that is functional (see details below), registration will commonly be refused.

A note about trade dress registration and functionality in the U.S.

Key Elements

Depending upon the nature of how the design is being used/depicted, the design may qualify as trade dress that may be registered as a trademark.

In this particular case, the mark is likely being used in the nature of a trade dress. Accordingly, the enquiry will be whether the design is sufficiently **distinctive** so as to serve a source-indicating function. Different rules apply to product designs versus product packaging.

- *Product packaging* can be *inherently distinctive* and registered on the Principal Register. In determining whether the product packaging trade dress is inherently distinctive, courts will look to whether the proposed mark is:
  - a "common" basic shape or design;
  - unique or unusual in the field in which it is used;
  - a mere refinement of a commonly adopted and well-known form of ornamentation for a particular class of goods viewed by the public as a dress or ornamentation for the goods; and
  - capable of creating a commercial impression distinct from the accompanying words.

If the product packaging is not inherently distinctive, provided the applicant can prove *acquired distinctiveness* – *i.e.*, in the minds of the public, the primary significance of the elements of the product packaging sought to be registered as trade dress is to identify the source of the product, rather than the product itself – the design can be registered on the Principal Register with a notation as such or, as a last resort, on the Supplemental Register.

- *Product designs* are never, *per se*, inherently distinctive. Rather, an applicant must prove that the design has acquired distinctiveness (the same test as above applies, but with emphasis on the elements of the product design sought to be registered) in order to be registered on the Principal Register. Otherwise, the design may be registered on the Supplemental Register.

The distinction between registration on the Principal Register and on the Supplemental Register is important, as a Principal Registration:

- serves as *prima facie* evidence of the registrant's ownership of the mark and exclusive right to use the mark nationwide on, or in connection with, the goods/services in the registration;
- allows the registrant to bring an action concerning the mark in federal court without having to prove acquired distinctiveness;
- allows the registrant to record the registration with U.S. Customs, to prevent importation of infringing foreign goods; and
- can become incontestable such that the bases to challenge the registrant's exclusive rights in the mark are limited.

In the U.S., trade dress is functional and cannot serve as a trademark if a feature of that trade dress is "essential to the use or purpose of the article or if it affects the cost or quality of the article".[5] This "functionality doctrine" is intended to encourage legitimate competition, by maintaining a proper balance between trademark and patent law. As the Supreme Court explained, in *Qualitex*:

> The functionality doctrine prevents trademark law, which seeks to promote competition by protecting a firm's reputation, from instead inhibiting legitimate competition by allowing a producer to control a useful product feature. It is the province of patent law, not trademark law, to encourage invention by granting inventors a monopoly over new product designs or functions for a limited time … after which competitors are free to use the innovation. If a product's functional features could be used as trademarks, however, a monopoly over such features could be obtained without regard to whether they qualify as patents and could be extended forever (because trademarks may be renewed in perpetuity).[6]

Thus, this doctrine ensures that protection for utilitarian product features be sought through a limited-duration utility patent and not through the potentially unlimited protection of a trademark registration. Upon expiration of a utility patent, the invention covered by the patent enters the public domain and others are then free to copy the functional features disclosed in the patent, which encourages advances in product design and manufacture.

In *TrafFix Devices, Inc. v. Mktg. Displays, Inc.*,[7] the Supreme Court reiterated the above rationale and also noted that evidence of acquired distinctiveness cannot trump the functionality doctrine. That is to say that even when the evidence establishes that consumers have come to

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[5] *Qualitex Co. v. Jacobson Prods. Co.*, 514 U.S. 159, 165, 34 USPQ2d 1161, 1163-64 (1995) (quoting *Inwood Labs., Inc. v. Ives Labs., Inc.*, 456 U.S. 844, 850, n.10, 214 USPQ 1, 4, n.10 (1982).
[6] *Id*.
[7] *TrafFix Devices, Inc. v. Mktg. Displays, Inc.*, 532 U.S. 23, 34-35, 58 USPQ2d 1001, 1007 (2001).

associate a functional product feature with a single source, trademark protection will not be granted, in light of the public policy reasons stated.[8]

A determination of functionality normally involves consideration of one or more of the following factors, commonly known as the "*Morton-Norwich* factors":

- the existence of a utility patent that discloses the utilitarian advantages of the design sought to be registered;
- advertising by the applicant that touts the utilitarian advantages of the design;
- facts pertaining to the availability of alternative designs; and
- facts pertaining to whether the design results from a comparatively simple or inexpensive method of manufacture.[9]

Do you need to register trademarks to obtain rights?

In most countries, the answer is yes – without a registration in that particular jurisdiction, you have no rights. However, in certain common law countries, like the U.S., Canada and the U.K., a certain degree of trademark rights derive from use of the mark. Accordingly, while registration of the mark is not always required to enforce trademark rights, it is highly recommend, due to the advantages afforded by the registration. For example, in the U.S. federal registration provides: notice to the public of the registrant's claim of ownership of the mark; a legal presumption of ownership nationwide; and *prima facie* evidence of the owner's exclusive right to use the mark on, or in connection with, the goods or services listed in the registration. Moreover, the owner can record the registration with U.S. Customs, in order to attempt to stem the tide of counterfeit goods into the U.S.

In the prosecution/registration process, oftentimes obstacles are encountered, such as third-party citations by the Trademark Office or claims/oppositions by third-party owners of trademarks. Recommendations for overcoming these obstacles include:

- *limiting the scope of goods or services covered in the application*;
- *negotiating the assignment/purchase of a trademark* – approaches are typically made to the trademark owner on a "no names" basis, and the eventual assignment can either be performed through an intermediate assignee or, as a last resort, with the true party of interest; and
- *entering into coexistence agreements and letters of consent* – note that sometimes the relevant Trademark Office has discretion as to whether it accepts the agreement/consent, and it will only do so in cases where it does not believe that confusion will be likely to result.

What rights does it confer upon the owner?

Generally speaking, the owner of a trademark has the right to prevent others from registering or using an identical or confusingly similar mark in connection with goods or services that are identical or similar to those of the trademark owner. This would include situations where the third party is using another's mark in an effort to confuse or deceive consumers into believing that:

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[8] *Id*.

[9] In *re Becton, Dickinson & Co*., 675 F.3d 1368, 1374-75, 102 USPQ2d 1372, 1377 (Fed. Cir. 2012); In re *Morton-Norwich Prods., Inc.*, 671 F.2d 1332, 1340-1341, 213 USPQ 9, 15-16 (C.C.P.A. 1982).

- the third party is affiliated, connected or associated with the trademark owner;
- the third party's goods or services derive from the trademark owner; or
- the trademark owner sponsors or approves the third party's goods or services.

This test is generally referred to as the "likelihood of confusion" test. While courts around the world apply different forms of this test, below is a list of factors courts commonly consider in determining whether a likelihood of confusion exists:

- the similarity of the marks (*e.g.*, sound, appearance, overall commercial impression);
- the similarity of the goods or services offered under the marks (*e.g.*, do consumers normally encounter the goods or services being sold under the same brand);
- the similarity of the marketing channels used (*e.g.*, retail outlets, nature of purchasers and their purchasing patterns, advertising media);
- the degree of care exercised by consumers (*e.g.*, the price of the product);
- the strength of the plaintiff's mark (strength potentially relates to both legal strength and market strength (*i.e.*, name recognition));
- the intentions of the defendant in selecting its mark (*e.g.*, did the defendant know about the plaintiff's mark and intentionally adopt a similar mark?); and
- any evidence of actual confusion.

Registered trademarks also offer strong enforceable rights to stop the manufacture, importation, distribution and sale of counterfeit goods. If the trademark registrations are renewed and the marks are continuously used (as required), registered trademarks can provide an almost perpetual monopoly right.

Famous and Well-known Marks

If a mark is deemed **famous**, it may be granted special protection, such that rights attach with respect to all classes of goods and services. In, *e.g.*, the U.S., actions by owners of such marks can pursue infringers not only on grounds of likelihood of confusion, but also dilution. That is to say that the use of a mark that is confusingly similar to famous mark leads to:

Blurring – meaning that the connection in consumers' minds between the famous mark and the goods or services with which that mark is used is weakened; or

Tarnishment – meaning that the defendant's use is unsavory or unwholesome, or the mark is used in connection with inferior products.

In countries that are signatories to the Paris Convention, if a mark is deemed **well known** in relation to the goods or services with which it is used, the mark may be afforded special protection – in some cases, irrespective of whether or not the mark has been filed for or registered in the relevant country.

D. Patents

Patents protect inventions – the physical embodiments of ideas. Invented materials used in the manufacture of fashion items or luxury goods, as well as innovative methods of manufacturing these goods, could be the subject of patent protection in numerous countries around the world.

1. What is it?

Definition

A patent is a property right that is limited in duration and relates to an invention. The claims of a patent define the limits of a patent owner's right to exclude (like a property deed).

Although the requirements for patent protection are territorial in nature and may be slightly different in each jurisdiction, in general in order to qualify for patent protection, the invention must be new, useful and non-obvious.

Also, many countries have "on-sale bars", which immediately and permanently foreclose any patent rights if, prior to filing the patent application:

- the invention is on sale anywhere in the world;
- the invention is in public use anywhere in the world;
- the invention is described in a printed publication anywhere in the world; or
- the invention is otherwise available to the public anywhere in the world.

Below are brief summaries of the laws governing patents, and, set out in italics, examples of patents or inventions relevant to the luxury and fashion goods industry in a number of key countries around the world.

Argentina

Patents and utility models are presently governed and protected by Law No. 24,481 as amended by Law No. 24,572 and Law No. 25.859, as well as its Regulatory Executive Order No. 260/96.

The salient rules are as follows:

- Any individual or legal entity, either national or foreign, is entitled to obtain patent and/or utility model certificates.
- "Invention" is defined as any patentable device or process created by an independent effort, capable of transforming matter or energy for the benefit of humankind.
- Inventions of products and processes are patentable if they are novel, involve an inventive activity and are capable of industrial application. While absolute novelty is required, the disclosure of the invention at an exhibition or in a publication, or other means of communication, within one year prior to the patent application date or priority date shall not affect its novelty.
- Patents and utility models are subject to annuities.
- Exclusive rights granted to the patentee consist of excluding third parties from the manufacture, use, offer to sell, sale and importation of the patent.
- The law provides that inventions made by an employee in the course of his or her employment contract, or during the course of his or her labor relationship, shall belong to the employer, provided the purpose of such contract or relationship involves inventive activities, either partially or totally.

Australia

A patent gives the owner an exclusive right to commercially exploit the invention for the duration of the patent. Standard patents and innovation patents may be registered.

Standard patents must be novel and inventive when compared to information made publicly available anywhere in the world, either by prior publication in a document or by the doing of an act, before they can be protected. This means that only materials or methods of manufacture that are not currently known can be subject of protection, so access to this system is relatively limited.

Innovation patents provide a “second tier” patent protection system, and cover lower level or incremental innovations that, under the standard patent system, do not meet inventive threshold requirements, while offering the same scope of protection as standard patents.

Manufacturers of luxury goods that connect or work with new technologies have used the patents system to protect their inventions. Manufacturers of cosmetics or skin care products who develop new ingredients could also benefit from patent protection if the novelty and inventive step requirements are met. Innovation patents could be used for protecting innovative packaging or display units used as part of a store layout.

Brazil

The Brazilian IP law provides for two types of patents: inventions and utility models. There are three prerequisites for the patentability of a creation: novelty, inventive activity and industrial applicability. For an invention to be patented, it must be considered new, *i.e.*, not included in the state of the art.

Patent protection in the fashion industry in Brazil usually encompasses technological innovations applied to textiles (mainly in sports clothing). If the accessory or piece of clothing consists of a known product with a new practical effect that is given by a new form or presentation (improving its use or the manufacturing thereof), it may be protected as a utility model patent.

Canada

Fashion designs and designs of luxury goods are generally not patentable, as the patent regime targets function rather than aesthetics. That said, certain textile or manufacturing processes might be patentable, if they satisfy the requirements for novelty, utility and ingenuity (*i.e.*, non-obviousness).

China

The Patent Law has been amended three times since its enactment in 1985, with the latest changes taking effect on 1 October 2009. The revised *Implementing Regulations of the Patent Law of the People’s Republic of China* came into effect on 1 February 2010.

Design patent registration is available for innovative fashion designs. New designs, shapes, patterns, combinations of colors, shapes and patterns that have an aesthetic appeal and are fit for industrial application may be patentable.

EU

Inventions eligible for patent protection must be new, involve an inventive step, and have an industrial application.

Patents cannot be used to protect ornamental creations as such: they can only be used to protect technical features incorporated in such creations: *e.g.*, a new fabric, folding technique or clasp system.

France

Inventions eligible for patent protection must be new, involve an inventive step and have an industrial application.

Fashion and luxury goods designers may also resort to patent law to protect their creations. However, patents cannot be used to protect ornamental creations as such: they can only be used to protect technical features incorporated in such creations, such as a new fabric, a folding technique or a clasp system.

Italy

Inventions eligible for protection must be new, involve an inventive activity and be capable of having an industrial application.

Registration of patents and utility models can serve as means of protection for certain luxury and fashion articles; however, registration is typically limited to innovative technical features of a product or its manufacturing process (e.g., an innovative technical fabric, component or functional structure – the sole of shoes or a watch mechanism); or, in the case of utility models, to innovations that confer a product a special effectiveness or convenience of use.

UK

A patent is available for an "invention" if it is new/novel, involves an inventive step and is capable of industrial application. In order to avoid destroying novelty, care must be taken not to disclose to the public prior to the patent application being filed the invention for which patent protection is sought. Unlike registered designs, there is no "grace period" for disclosure, and once novelty has been destroyed by publication anywhere in the world, patent protection in the UK will no longer be available.

There are, however, a number of exclusions from the definition of "invention". With respect to the fashion and luxury industry, the most pertinent of these are artistic works and any form of esthetic creation.

U.S.

In exchange, or consideration, for disclosing his or her invention, the patentee receives from the U.S. government a patent in any invention that is a product or process (method), if such invention is new, useful and non-obvious.

Three types of patents can be registered:

- *Utility patents* may be granted to anyone who invents or discovers any new and useful process, machine, article of manufacture, or composition of matter, or any new and useful improvement thereof;
- *Design patents** (which in some jurisdictions are referred to as industrial designs, see *Types of IP - Industrial Designs/Designs* section above) may be granted to anyone who invents a new, original and ornamental design for an article of manufacture; and
- *Plant patents* may be granted to anyone who invents or discovers and asexually reproduces any distinct and new variety of plant.

***Design patents** are a form of protection for ornamental designs (*i.e.*, designs not dictated by function). The design must relate to surface ornamentation of an article of manufacture and does not include internal portions of the article. The United States Patent and Trademark Office

(USPTO) examines design patent applications for novelty and non-obviousness through application of an "ordinary observer" test. This test asks whether the design is substantially the same as prior art when viewed by a hypothetical ordinary observer. *Examples of luxury and fashion articles on which design patents exist include ornamental features of handbags, watches, shoes and sunglasses*.

On-Sale Bar: Patent protection may not be available if the invention or product embodying the invention was sold or disclosed (e.g., published in a magazine or publicly displayed) anywhere in the world more than one year prior to the date of filing the U.S. patent application.

2. Do you need to register patents to obtain rights and what rights does a registration confer upon the owner?

Yes, you must register your patent in each relevant jurisdiction to obtain rights. In most jurisdictions around the world, including the U.S., the first to file for (and eventually obtain) the patent has prior rights over any third parties. In order to quickly get an application on file, consider filing a provisional patent application.

Benefits of obtaining patents include:

- obtaining a monopoly on the product/invention for a set term;
- strategic control over future markets, to prevent competitors from entering;
- ability to prevent employee misappropriation;
- creating a more compelling value proposition to investors (patents are increasingly looked to as a measure of a company's innovation/research and development); and
- possessing a defensive weapon against competitors.

In general, owners of patent registrations possess an exclusive right over the protected invention, including the right to exclude others from making, using, offering for sale, selling the invention in the relevant jurisdiction or importing the invention into the relevant jurisdiction. If the patent protects a process, the exclusive right is extended to the right to prevent third parties from implementing such process, as well as from making, using, offering for sale, selling the product created as a result of using the invention in the relevant jurisdiction or importing such a product into the relevant jurisdiction. The exercise of any of these rights without authorization of the patent owner amounts to patent infringement.

The grant of a patent does not afford affirmative right to practice the invention.

Keep in mind that once the patent issues, the details of the invention will be publicly available; therefore, any trade secrets rights your company possesses in the invention will be lost.

As the registration process is quite expensive and can take up to (or, in many cases, more than) one year, the companies in the fashion and luxury goods sector generally seek patent protection only for key technologies or designs that will stand the test of time and are of strategic value for the company.

E. Domain Names

1. What are they?

Entities usually own a number of domain names, either in generic top-level domains (gTLDs), such as .com, .net, .biz, etc., or in country-code top-level domains (ccTLDs), such as .us, .eu, .co.uk, etc. While technically not a form of IP, the manner in which domain names are used (as well as content on the websites to which the domain names resolve) often results in IP infringement/enforcement issues. We will discuss that in more detail in *Registration of Your IP and Term Of Protection* section of this chapter.

2. What rights does registration confer upon the owner?

Generally, registration of the domain name simply means that others cannot register that identical domain name. For example, if you register “luxuryfashion.com”, a third party would not be able to register that identical domain name in the .com space, but another party could register either a variation of “luxuryfashion” as a .com, *e.g.*, luxury-fashion.com, or even “luxuryfashion” in another gTLD or ccTLD, *e.g.*, luxuryfashion.net.

F. Trade Secrets

1. What are they?

Generally speaking, trade secrets consist of information – such as a formula, pattern, compilation, program, device, method, technique or process – that:

- derives independent economic value, actual or potential, from not being generally known to, and not being readily ascertainable by proper means by, other persons who can obtain economic value from its disclosure or use; and
- is the subject of efforts that are reasonable under the circumstances to maintain its secrecy.

Examples include a formula for a chemical compound, a process of manufacturing, treating or preserving material, a pattern for a machine or other device, customer lists.

Important factors a business owner should consider in determining whether information owned and used by his or her business is a trade secret include:

- the extent to which the information is known outside the owner’s business;
- the extent to which it is known by those involved in the owner’s business;
- measures taken to guard the secrecy of the information;
- the value of the information to the owner or to his or her competitors;
- the amount of effort or money expended by the business in developing the information; and
- the ease or difficulty with which the information could be properly acquired or duplicated by others.

Businesses should ensure that appropriate non-disclosure agreements are executed by relevant employees, and others, as necessary.

In the U.S., the Uniform Trade Secrets Act (UTSA) provides a legal framework for improved trade secret protection, and aims to codify and harmonize standards and remedies regarding misappropriation of trade secrets as these concepts have emerged in common law on a state-to-state basis. As of October 2014, the UTSA was enacted by 47 states, and by the District of Columbia, Puerto Rico and the U.S. Virgin Islands.

2. What rights does it confer upon the owner?

The owner of a trade secret has the right to retain the secrecy of its trade secret. Under the UTSA, if the trade secret is misappropriated (see definition below), the owner of the trade secret has a number of potential remedies, including injunctive relief, damages and attorney's fees.

The UTSA defines "misappropriation" as:

i. acquisition of a trade secret of another by a person who knows or has reason to know that the trade secret was acquired by improper means (*i.e.*, theft, bribery, misrepresentation, breach or inducement of a breach of a duty to maintain secrecy, or espionage through electronic or other means); or
ii. disclosure or use of a trade secret of another without express or implied consent by a person who
   a. used improper means to acquire knowledge of the trade secret; or
   b. at the time of disclosure or use, knew or had reason to know that his knowledge of the trade secret was
      (i) derived from or through a person who had utilized improper means to acquire it;
      (ii) acquired under circumstances giving rise to a duty to maintain its secrecy or limit its use; or
      (iii) derived from or through a person who owed a duty to the person seeking relief to maintain its secrecy or limit its use; or
   c. before a material change of his [or her] position, knew or had reason to know that it was a trade secret and that knowledge of it had been acquired by accident or mistake.[10]

III. Registration of Your IP and Term of Protection

IP is territorial in nature and laws differ in each country. With this in mind, in many countries, you do not own rights to your IP unless you register the IP. This is particularly true for patents, trademarks and domain names. For copyrights, in most jurisdictions outside of the U.S., copyright exists at the time of creation. For trade secrets, registration is not required, as the details of this IP asset must remain secret in order for the protection to exist.

In the luxury and fashion industry, oftentimes selling cycles are short; therefore, the longer it takes to obtain protection of the IP, the less value is garnered from the protection. In this regard, copyright and design protection may afford the owner with the most timely and cost-efficient means of protection. The costs and registration timeframe for trademarks varies from country to country, with filing to registration ranging from a few months to several years, and costs ranging

[10] *See* UTSA (amended 1985) § 1.2, 14 U.L.A. 531-32 (1979).

from as little as US$1000 to $5000 or more per country. Therefore, trademarks can also serve as a useful form of protection. (One exception being trade dress applications, which may take significantly longer, depending upon whether or not the trade dress is inherently distinctive.) While design patents are generally less expensive and quick to proceed to registration than utility patents, timing from filing to registration can be well in excess of a year and the costs can amount to thousands, and possibly tens of thousands, of dollars. Therefore, the investment in registering trade dress and patents is usually limited to long-term products with significant economic importance and return on investment.

EU

All EU countries provide for a number of different legal instruments (copyrights, designs, trademarks, patents) designed to protect various aspects of fashion and luxury goods. Concurrently or alternatively to these national protections, designers can protect their creations on a European level. Indeed, the European legislation grants designers three legal tools allowing them to benefit from uniform protection over the territory of the EU: Community registered and unregistered designs, community trademarks, and, in the near future, Unitary patents.

It is worth noting that copyright law has not been harmonized at the European level. Thus, there is no uniform European copyright protection available and designers seeking copyright protection must rely on the applicable law of each European country.

In the *Types of IP* section, we discussed the benefits afforded to IP owners. Below, we outline the general registration considerations, additional benefits of registration of your IP, and terms of protection for each form of IP. Please note that each country has specific requirements and registration processes and, although charts listing terms of protection are included below, terms may be measured differently in each jurisdiction; therefore, we recommend consulting with counsel with respect to the registration process and specific term of protection for each of your company's IP assets.

A. Copyrights

Copyright generally exists once the particular idea is fixed into a tangible medium. In light of this, many countries around the world do not have any process for registering copyrights. However, in certain jurisdictions, registration has valuable benefits and may, in fact, be required in order to sue infringers and obtain the benefit of the full range of damages in an infringement action.

With respect to the term of protection, generally these are measured from the life of the author of the work. Terms may differ depending upon the nature of the work, whether it was a work-for-hire, a jointly authored work, etc. In addition, as mentioned earlier in this chapter, a number of countries recognize an author's economic and moral rights in a work.

Details on these points in certain key jurisdictions are below.

1. Registration Process/Benefits

Argentina

A copyright form must be submitted before the Argentine Register for Copyrights jointly with a copy of the registrable work (in whichever means/support). Depending on the type of work being registered, it may be registered on the same day.

Argentine works must be registered with the National Copyright Office. If they are not, third parties may freely copy or use the work, provided it is not altered and contains an attribution to the author.

Australia

Australia has no system of copyright registration. Copyright protection arises automatically when the subject matter is created or published, if certain criteria are met. Most commonly, this involves demonstrating that the author, or one of the authors, of the material to be protected was a citizen or resident of Australia or of a country with which Australia has a treaty for mutual recognition of copyright. Published material is also protected in Australia on the alternative basis that the country of first publication was Australia or such a treaty country. Australia is a member of the Berne Convention and the World Trade Organization and so extends copyright protection to material created by citizens or residents of most countries in the developed world, as well as many developing nations. In April 2007, Australia acceded to the World Intellectual Property Organization (WIPO) Internet Copyright Treaties, the WIPO Copyright Treaty and the WIPO Performance and Phonograms Treaty.

Copyright in works such as literary or artistic material is owned by the author. Australian law treats the person or persons who provide the creative input as author(s).

Brazil

The protection of copyrights in Brazil does not depend on mandatory registration of the work with any government authority. Nevertheless, the author may register the work to indicate, among other things, the date of creation of the work.

Since the author of a creative work will necessarily be a natural person, a legal entity may not be the original creator of a work. Additionally, copyright assignments are restrictively interpreted in favor of the author. In view of that, special care is required to ensure that the natural author fully and thoroughly assigned the economic rights over the work to the company that will exploit them.

Canada

The Copyright Act of Canada provides for a voluntary copyright registration scheme. Copyright registration is fairly straightforward and is made by submitting (i) an application form and (ii) the prescribed fee.[11] Neither the actual work nor a copy is required to be filed. Registration grants no special rights or remedies, but the issued certificate is *prima facie* proof of copyright ownership (*i.e.*, a registration certificate creates a presumption in favor of the registered owner).

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[11] The fee is currently CAD$50 if the application is submitted online, or CAD$65 if submitted through other means. If registration is required on an expedited basis, the prescribed fee is CAD$65.

Where a copyright has been registered, an infringer is presumed to know that the work in question was copyright protected.

Where a copyright is not registered, the Copyright Act provides that copyright is presumed to exist in the work until the contrary is proved by the defendant. A presumption of ownership exists whereby the maker of the goods is presumed to be the owner of the copyright. However, where the plaintiff is an assignee or exclusive licensee of a work, the burden will be on the plaintiff to establish ownership of the copyright in the work.

China

Copyright registration is available under the 1995 *Trial Measures for the Voluntary Registration of Works*. Registration is not a precondition to copyright enforcement, but it may provide helpful evidence of ownership in enforcement actions. Applicants for registration may be authors, other individuals or legal persons holding copyrights, owners of exclusive rights or their agents.

France

There is no registration system for copyrights, since copyright protection is conferred to the author by the sole fact of creation. Pursuant to the 1886 Berne Convention, foreign authors may rely on their copyrights in other countries to benefit from copyright protection in France.

However, in order to enforce copyrights in the context of litigation, it is advisable to gather evidence as to the date of the creation of the work. In this respect, authors may chose to file an *enveloppe Soleau* with the INPI, which is an envelope containing a written description, or a 2D representation of the creation. *Enveloppes soleau* do not create copyright in themselves but allow the author to have a definite date for his or her creation.

French law stands out from most of the other EU countries, as the emphasis placed on copyright protection, both in practice and in case law, is extremely strong in France. Indeed, copyright protection is systematically claimed in fashion design litigation.

French copyright law grants the author economic and moral rights, thus conferring designers full control over their creations. **Economic rights** include the rights to reproduce, represent, adapt and market the protected work. The exercise of any of these rights without the authorization of the author amounts to copyright infringement. **Moral rights** include the right for the author to choose to divulge his or her work to the public, to be identified as the author of the work, to oppose any distortion or modification of the work, or to withdraw the work previously disclosed to the public.

The issue of copyright ownership in the context of litigation bears mentioning. Normally, the plaintiff must demonstrate that it owns the copyrights in the work it claims is being infringed, either because it has created it, or because the copyrights have been regularly assigned to it.

However, in order to facilitate copyright infringement proceedings, French courts have developed a presumption of ownership theory, pursuant to which when a person exploits a protected work under its name, it is presumed to own the copyrights on such work. Such presumption is rebuttable and the defendant will have to produce evidence to the contrary.

In terms of the law, the French Intellectual Property Code (IPC) provides that copyright protection is afforded to all original works by the mere fact of their creation, which means that there is no possibility of copyright registration, and, *a fortiori*, no registration requirement for a work to benefit from copyright protection. It is worth noting that fashion designs are specifically listed as copyrightable work in the IPC, under the obsolete designation of "*clothing and jewelry creations of seasonal industry*". French copyright law protects all works, regardless of their merit or destination, as long as they have a material form and are original.

As for the material form requirement, it usually does not raise any particular issue for fashion and luxury goods, with the notable exception of fragrances. Indeed, French courts refuse to grant copyright protection to fragrances, because, as recently stressed by the French Supreme Court, fragrances do not have a sensible form identifiable with sufficient precision to allow its communication.

As for the originality requirement, in order to be deemed original and thus benefit from copyright protection, fashions and luxury goods designs must bear the mark of the designer's personality, and show that the designer has made a creative effort, consisting in an arbitrary choice devoid of technical considerations.

The difficulty for the fashion industry is that most of the elements composing a creation either belong to the public domain, are imposed by a fashion trend (which cannot in itself be appropriated) or have a functional purpose.

Thus, French courts rule that fashion creations are protected by copyright where, although all the elements composing it, taken individually, belong to the public domain, the combination or layout of all these elements taken as a whole produce an overall effect that bears the mark of the personality of their author.

In practice, in order to prove that a fashion design is not original, defendants tend to demonstrate that the litigious design is common and does not depart sufficiently from prior works, thus mixing up the criteria of novelty (proper to designs, see below), and originality.

It is worth noting that although the merit of the creation is not supposed to be taken into consideration by the judges, in practice the notoriety of the "*grande maison*" often plays a part. For instance, the originality of Longchamp's flagship bag "*pliage*" has been challenged many times before French courts but always confirmed, even though evidence of prior similar trademarks had been brought and even though trademarks for the shape of such product had been cancelled for lack of distinctiveness.

Overall, copyright protection is attractive to designers, since it is simple and inexpensive and protects the work as a whole. However, copyright protection is not devoid of inconveniences, the most important being that in the absence of registration, it is often difficult to prove the date of the creation of the work and the ownership over it.

Copyright protection can be enjoyed concurrently with registered industrial property rights, *i.e.*, designs, trademarks and patents.

Germany

Copyright protection in Germany accrues from the creation of the work and does not depend on a registration or an official grant.

Italy

Neither registration nor other formalities are required as a prerequisite for copyright protection under the copyright law. Formalities and/or registrations with the competent Collecting Society (SIAE) may serve to prove that the registrant is the author of certain types of work (*e.g.*, software, unpublished work of literature or visual artworks), as well as the date of creation, in the absence of proof to the contrary. However, the omission of such formalities is not prejudicial to the copyrightability of the work.

Japan

Japan is a contracting member of the Berne Convention, and therefore, the enjoyment of copyrights is not subject to any formality requirement.

Mexico

The registration of copyrights is not mandatory; however, it is however highly recommended, as it is useful in proving authorship. Note that authors must always be individuals, not companies or entities.

Russia

Registration is not required in order to receive protection under the Russian copyright law.

In order to enjoy protection, a work must exist in a objective form. Protection by the Russian copyright law is provided to works made public:

- within the territory of the Russian Federation, or not made public but existing in some objective form within the territory of the Russian Federation, and is recognized for authors (or their legal successors) regardless of their citizenship;
- outside the territory of the Russian Federation, or not made public but existing in some objective form outside the territory of the Russian Federation, and is recognized for authors who are citizens of the Russian Federation (or their legal successors); or
- outside the territory of the Russian Federation, or not made public but existing in some objective form outside the territory of the Russian Federation, and is recognized, in accordance with international treaties of the Russian Federation, within the territory of the Russian Federation for authors (or their legal successors) who are citizens of other states and persons without citizenship.

Spain

Copyright protection is conferred on its author by the sole fact of creation. Registration is not required for copyrights to be valid. Although registration is not compulsory to obtain copyright protection, there is an Intellectual Property Registry where works may be registered.

U.S.

Copyright exists upon creation. However, registration of a work may be obtained by submitting an application to the U.S. Copyright Office. Even though registration is not a requirement for protection, registration is highly recommended, as its benefits are significant, *e.g.*:

- registration is a public record of the owner’s copyright claim;
- registration allows an owner to file an infringement suit;
- if made before or within five years of publication, registration will establish *prima facie* evidence in court of the validity of the copyright and of the facts stated in the certificate;
- if registration is made within three months after publication of the work or prior to an infringement of the work, statutory damages and attorney’s fees are available; otherwise, only actual damages and profits are available; and

- the owner can record its registration with U. S. Customs and Border Patrol, as a means of protection against the importation of infringing copies.

2. Term of Protection

While there is a broad range of complexities in calculating copyright terms in each country, the chart below serves as a quick reference to the terms of copyright protection in key jurisdictions. After the chart are some additional details affecting the terms of protection. Note that moral rights of an author are perpetual in a number of jurisdictions.

As terms can vary depending upon the date of creation, nature and authorship of the work, we highly recommend consulting with counsel in order to ascertain the term of the protection for any specific works of authorship your company owns, especially if your company is considering any action against a third-party infringement.

Country	***Term (Author's life plus [x] years)***
Argentina	70
Australia	70
Brazil	70
Canada	50
China	50
France	70
Germany	70
Italy	70
Japan	50
Mexico	100
Russia	70
Spain	70
UK	70
U.S.	70

Argentina

As a general rule, copyright endures for a term consisting of the life of the author of the work, and 70 years from the first day of January subsequent to his or her death. With posthumous work, the lifespan of a copyright is 70 years from the first day of January subsequent to the author's death. For joint works, the term becomes effective from the first day of January of the year following the death of the last author. Anonymous works published by legal entities are protected for 50 years from their publication dates. With regard to cinematographic work, the copyright is protected for 50 years from the date of the last author's death. (The law considers the following individuals as authors unless otherwise agreed: scriptwriter, producer, director and soundtrack composer.) Copyright to photographic work lasts 20 years from the date the work is first published.

The term of copyright protection for foreign works varies, depending on the international treaty to which both the country of origin of the foreign work and the Argentine Republic are parties. However, the applicable term will not be longer than the one granted by Argentine law.

Australia

Copyright subsists in:

- published works (other than photographs) – for the author's life plus 70 years after the end of the calendar year in which the author dies;
- unpublished works – for 70 years after the end of the calendar year in which the work is first published; and
- photographs – until 50 years after the end of the calendar year in which the photograph was first published.

Brazil

Copyrights in Brazil comprise the economic and moral rights of the author. Moral rights cannot be licensed, transferred or waived. As to the author's economic rights, the copyright protection lasts for 70 years as of 1 January of the year following the author's death or as of the work's first publication.

Canada

The term for copyright protection is the life of the author plus 50 years after the author's death, and the remainder of the calendar year in which the author dies, after which time the work becomes part of the public domain.

China

Under the Copyright Law of the People's Republic of China, an author's moral rights of attribution, revision and integrity are perpetual, while a citizen's right of publication and the various economic rights are protected for the life of the author plus 50 years. On the other hand, for works of legal persons or other organizations, the right of publication and other economic rights are protected for a period of 50 years from first publication, expiring on 31 December of the 50th year.

France

Copyrights in France are composed of economic rights and moral rights. Economic rights on copyrightable works are protected during the author's life and 70 years thereafter. Moral rights are perpetual, inalienable and imprescriptible and pass to the author's heirs after his or her death.

Italy

The term of duration for economic rights is the author's life and 70 years thereafter. Moral rights on copyright work are inalienable and imprescriptible.

Japan

As of the date of this publication, the term of protection for a copyright is the life of the author plus 50 years. There is a possibility that in the near future the term of copyright protection will be extended to 70 years.

Russia

An author's moral rights (rights to authorship, the name of the author, and the inviolability of the work) are perpetual and may be enforced by the heirs of the author after his or her death.

UK

Below is a chart reflecting the various terms of copyright in the noted types of works.

Type of Work	***Normal Duration***
Literary, Dramatic or Musical Work	Author's life +70
Artistic Work	Author's life + 70
Sound Recording	50 years from making or 70 years from release if within 50 years of making * *Increased to 70 years by Directive 2011/77/EU, which has been implemented in the UK by the Copyright and Duration of Rights in Performances Regulations 2013, which came into force on 1 November 2013.
Film	"Person's Connected" + 70
Broadcast/Cablecast	50 years from first transmission
Published Edition	25 years from first publication
Database (sui generis)	15 years from making (s17 Database Regs) or 15 years from being made public if made public within that 15 years

U.S.

For works created on or after 1 January 1978, the term of copyright protection is the author's life plus 70 years after the author's death. For works made for hire on or after 1 January 1978, the term is 95 years from publication or 120 years from creation, whichever is shorter.

B. Industrial Designs/Designs

Where available, the registration processes for and benefits of registration of these types of IP are highly specific and differ from jurisdiction to jurisdiction. Below is an overview of the processes/benefits of registration, as well as an outline of the terms of protection for the designs in certain key jurisdictions.

One filing system that provides certain efficiencies from a time and resource perspective is the **Hague Agreement for the International Registration of Designs and Models (the Hague System)**. The Hague System allows an applicant to register up to 100 designs in over 62 territories (as of 31 October 2014) by filing one single international application. While the term of registration for designs is usually short (initial terms of five years in a number of countries), the registration process is usually quicker and less expensive than those for trademarks and patents. Accordingly, registering designs is well suited to the fashion industry, where many designs have a lifespan of less than five years.

1. Registration Process/Benefits

Argentina

Once an application is filed, there is no substantial examination. The examination is limited to the verification of the formal requirements. Provided all of the formal requirements have been satisfied, industrial models and designs are usually granted in approximately four working days from the date the application is filed.

In the luxury and fashion industry, registration of industrial models and designs is usually an effective way to protect a shoe design, a belt buckle, a purse shape, etc. By registering these as industrial models and designs, the registration will protect the design applied to any product (contrary to trademarks that have to be filed in each of the 45 international classes of interest).

The law provides for the transfer of industrial designs, cancellation actions, and civil and criminal actions arising from infringement of an owner's rights.

Australia

In order to register a design, the two critical requirements are that the design be new and distinctive. A design is new unless it is identical to a design that forms part of the relevant prior art base. It is distinctive unless it is substantially similar in overall impression to a design forming part of the relevant prior art base. The prior art base comprises designs that have been publicly used in Australia, designs that have been registered or applied for in Australia and designs that have been published in a document anywhere in the world. "Publication" includes any commercial use, public viewing or publication of the design. Use of the design will be considered "public use" if the use has taken place in such a manner that a member of the public would have been freely able to ascertain the design. The relevant time to test the newness and distinctiveness of a particular design is when the application is lodged for registration with the Designs Office or when the priority application is filed overseas.

To register a design, an application form must be filed at the Designs Office, containing prescribed details and including representations of the design.

The Designs Office examines the design to ensure that it meets formal requirements for registrability and, if it does, a certificate of registration is issued. No substantive examination is made at this stage.

Once a design has been registered, either the owner, a court or a third party can request a substantive examination of the design. A substantive examination is the procedure by which the registrar determines whether a design is valid. Only once a design has been found to be valid and is certified as being valid, will the owner be able to enforce the design and prevent others from using similar designs. If the registrar concludes that the design is not valid, the design will be revoked.

Brazil

Applications for industrial designs are not subject to substantive examination; therefore, the grant of the registration occurs immediately after the formal analysis is concluded (usually less than a year).

Canada

An application for industrial design has three basic elements: the application form; at least one drawing or photograph of the design; and the fees. Applications must be filed within 12 months of publication of the design. “Publication” means making the design available to the public by, for example, offering it for commercial sale or use anywhere in the world. The industrial design registration process consists of the following six phases: (i) initial processing (including the issue of a filing certificate); (ii) classification; (iii) preliminary examination; (iv) search; (v) examination; and (vi) registration.

EU

Registered Community Designs

Any natural or legal person, an EU resident or not, may register a Community design by filing a design application with OHIM. The application must contain a graphic representation of the design, which may be completed with a short description of the design. A single application can claim protection for multiple models (up to 99), which must pertain to the same class.

The registration protects the design throughout the entire territory of the EU. Thus, it is a fast and effective way to obtain protection in all the countries of the EU.

OHIM carries out a cursory examination to ensure that the application complies with the formal filing requirements; however, no examination is performed with respect to the novelty or the individual character requirements. Designs are usually registered within a few months upon the filing of the application, if there is no formal issue with the filing and no deferment.

Once the application passes the formal examination, it proceeds to registration and is published, unless the applicant decides to defer the publication for a maximum period of 30 months, in order to preserve secrecy. Designs are usually registered within a few months upon the filing of the application, if there is no formal issue with the filing and no deferment.

No opposition procedure currently exists for registered Community designs. Third parties may challenge the validity of the design in cancellation proceedings before OHIM or by way of a counterclaim in infringement proceedings.

Unregistered Community Designs

Unregistered designs are automatically protected within the territory of the EU, provided that they satisfy the substantive conditions for protection.

France

Any natural or legal person of French or foreign nationality may apply for a French design by filing a design application with the INPI. The application must contain a graphic representation of the design, which may be completed with a short description of the design. A single application can claim protection for multiple models, which must pertain to the same class. The registration protects the design within mainland France territory and overseas territories. However, the applicant must request for an extension if protection is needed for New Caledonia and French Polynesia.

The INPI carries out a cursory examination to ensure that the application complies with the formal filing requirements, without examining the novelty or the individual character requirements.

Once the application passes the formal examination, it proceeds to registration and is published, unless the applicant decides to defer the publication for a maximum period of three years, in order to preserve secrecy. Designs are usually registered within three to four months after filing of the application, if there is no formal issue with the filing and no deferment.

No opposition procedure currently exists in France. Third parties may challenge the validity of the design in cancellation proceedings brought before the competent court.

Germany

Applications for a registered design are filed with the DPMA. The application for a registered design has to comprise pictures or drawings reproducing the design. Alternatively, the DPMA now also accepts CDs and DVDs with JPEG files. Since the pictures or drawings have a direct impact on the scope of protection, *e.g.*, since only features of the products shown on the drawings are protected, one should pay close attention to the selection of documents filed with the office.

Usually, the registration and publication of a design can be expected within three to five months after filing. The publication of the design may, upon application, be delayed for 30 months, in order to preserve secrecy.

Novelty and individual character of a design are not examined by the DPMA during the registration process. Therefore, a determination as to whether a design is capable of being protected or not is only made in the scope of infringement or cancellation proceedings.

Italy

Any natural or legal person of Italian or foreign nationality (the author of the design or his or her assignee) may apply for an Italian design by filing a design application with the IPTO or the competent Chamber of Commerce, Industry and Agriculture. A single application claiming protection for multiple models that pertain to the same class can be filed. The registration protects the design within the territory of Italy and in the State of San Marino, and may also be recognized in Vatican City.

The IPTO carries out a preliminary examination for the sole and exclusive purpose of verifying the design compliance with formal requirements for registration, without examining novelty or individual character requirements.

No opposition procedure currently exists in Italy. Designs are normally registered within five years from the filing of the application (although the IPTO recently sped up the registration procedure); nevertheless, exclusive rights can be exercised pending registration.

Japan

Every application for registration of a design is examined for novelty. The article a design is applied to should be limited to specific goods. If an examiner considers the design to be registrable, the examiner will then issue an official decision for registration of such design. The design will be registered upon payment of an annual fee for the first year. It generally takes about one year to register a design in Japan.

Mexico

The registration procedure for industrial designs is divided into two stages: an administrative examination and a technical examination. The administrative examination refers to formalities of the application, while the technical examination focuses on the technical aspects of the application: namely, novelty and industrial applicability. In order to comply with the novelty requirement, a design must have been created independently of any other known designs or combinations of known features of designs, and must differ significantly thereof. Without objections, the registration procedure for an industrial design usually takes between six to eight months.

Russia

Under current legislation, a patent for an industrial design is granted by Rospatent when an application is filed and contains, *inter alia*, the representation/drawings and the list of the essential features characterizing the design. The scope of protection will be defined by these items. The patent is granted after an examination of novelty and originality.

Spain

Industrial design protection can be obtained by filing an application for registration before the Spanish Patent and Trademark Office and paying the required fees. The Office will examine the application to determine whether it meets the legal requirements. If the application passes the formal examination, it will be published in the *Official Industrial Property Gazette*, and any person who considers himself or herself to be harmed may oppose the registration of the trademark within the following two months, by claiming that the application does not comply with the legal requirements for the registration or that there are incompatible prior rights.

UK

A UK design can be filed for with the UK Intellectual Property Office (UK IPO). The UK IPO will conduct only a relatively cursory examination to ensure that the design complies with the legal filing requirements. Once the application has been deemed acceptable, it will proceed immediately to registration. The UK IPO does not publish registered designs or conduct a search for prior registered rights.

2. Term of Protection

Note that, as shown in the chart below, the term may be counted from different starting points, *e.g.*, filing, publication or registration date, in different jurisdictions. Moreover, in jurisdictions where initial terms of registration may be extended, renewal forms and fees must be filed with the appropriate authorities to extend the term of protection.

Country	*Term*
Argentina	5 years (initial term); renewable for up to total of 15 years
Australia	5 years (initial term); renewable for up to total of 15 years
Brazil	10 years (initial term); renewable for up to total of 25 years
Canada	10 years
EU	*Registered Community Designs*: 5 years (initial term); renewable for up to total of 25 years *Unregistered Community Designs*: 3 years from date of publication or use in EU
France	5 years (initial term); renewable for up to total of 25 years
Germany	5 years (initial term); renewable for up to total of 25 years
Italy	5 years (initial term); renewable for up to total of 25 years
Mexico	15 years
Russia	15 years or 5 years (initial term); renewable for up to total of 25 years*
Spain	5 years (initial term); renewable for up to total of 25 years
UK	5 years (initial term); renewable for up to total of 25 years

**The Russian IP law has recently been amended, and significant changes came into force on 1 October 2014. In particular, the validity term of industrial designs changed from 15 years to an initial five-year term, renewable for up to 25 years.*

C. Trademarks

Prior to filing for a trademark, searches are usually conducted in the relevant jurisdictions. Searches are helpful, as they expose potential obstacles and risks prior to expending additional resources on registering the mark and investing in and developing the brand.

Once searches are performed and the decision to register the mark is made, applications are filed.

There are numerous filing strategies available and none are mutually exclusive. While we highlight certain of these strategies below, which one is pursued will depend largely on potential obstacles revealed in the searches, the countries of strategic importance to your business and budget restrictions. Counsel should be consulted as to which filing strategy best suits your company’s needs.

1. Considerations on Filing Strategies

A number of international treaties contain rules and protections in relation to IP assets. For trademarks, the most relevant of these are noted below:

Paris Convention for the Protection of Industrial Property (The Paris Convention): The Paris Convention is an international treaty relating to the protection of IP. Nationals of any country that is a member of the Paris Convention are afforded the same advantages with respect to IP that the national law grants its citizens. Under the Paris Convention, any person who files a trademark application in a member country may claim priority of that filing date if an application is filed in any other member country within six months from the date the original application was filed.

The Madrid System: The Madrid System encompasses two separate treaties, the Madrid Agreement and Madrid Protocol. The Madrid Agreement and Madrid Protocol provide an opportunity to file an application for an international registration (IR) that will cover multiple member countries. Under the *Madrid Agreement*, nationals of any signatory country may secure protection of their trademark registered in the country of origin in all other Madrid Agreement signatory countries. Under the *Madrid Protocol*, nationals of any signatory country may secure protection in member countries based on a pending application in the country of origin. Both the Madrid Agreement and Madrid Protocol are administered by the International Bureau of WIPO.

Regional Filing Strategies

In a number of regions, it is possible to file one application covering multiple countries. The main regional trademark filing systems are:

- **African Intellectual Property Organization (OAPI)**: OAPI was formed by members of certain French-speaking African nations and enables members to file one regional application for protection of trademarks in member countries.
- **African Regional Intellectual Property Organization (ARIPO)**: ARIPO was formed by members of certain English-speaking African nations and enables members to file one regional application for the protection of trademarks in member countries. Once a registration is obtained from ARIPO, the owner can protect its trademark in the member states in southern Africa.
- **Andean Pact**: The Andean Pact is an agreement among Bolivia, Colombia, Ecuador and Peru, members of the Andean Community, which provides for one common trademark law among the member countries. The Andean Pact does not provide a unitary registration applicable in all member countries, but it does provide for certain reciprocal rights upon request of the trademark owner. Such rights include:
  - use of a trademark in any one of the member countries constituting use of the trademark in any member country for the purpose of non-use cancellation proceedings; and
  - the right to file an opposition against a similar mark filed in the other member countries by an entity that first applied for registration of a trademark in any member country.
- **Benelux**: A registration with the Benelux Office for Intellectual Property (BOIP) covers Belgium, Luxembourg and the Netherlands.
- **Community Trade Mark (CTM)**: A CTM is a single unitary trademark right that must be applied for, and that provides protection for a trademark or service mark in all of the member countries of the EU. A CTM registration may be beneficial, as use in one

member country may be considered to be use in all member countries. There are also administrative efficiencies through maintaining a single registration.

2. Registration Process/Benefits

To register a trademark, one can either:

- file an application with the Trademark Office in each country or jurisdiction (*e.g.*, the EU) in which registration is sought; or
- file an application for an IR with the International Bureau of WIPO and then extend that IR into countries or jurisdictions that are party to the Madrid System.

The application will need to contain at least the following information:

- the full name, address and entity details of the applicant;
- particulars of the trademark;
- the goods and/or services to be covered by the application; and
- particulars of priority application(s) (and possibly a certified copy of the application) if Paris Convention priority is being claimed.

After the application is examined, it will either be approved for publication for opposition purposes or an official action from the Trademark Office will issue. Certain jurisdictions, such as the U.S., have complex rules relating to filing bases, proof of use and substantive examination guidelines and grounds for refusal (*e.g.*, descriptiveness, likelihood of confusion, etc.). Once all objections raised in the official action are resolved, the application will be approved for publication. Appeal and opposition procedures are also generally available, either *ex parte* or *inter parte*. Assuming no oppositions are filed, the application will mature into a registration in due course.

The registration process differs from country to country. Detail regarding all of these issues is outside the scope of this chapter, and we recommend local counsel be consulted in relation to filing and registration of trademarks in your company's countries of interest.

For the U.S., we provide an brief outline of filing and registration bases for a U.S. trademark application filed with the USPTO, as well as flowcharts depicting the basic registration process.

Filing bases include:

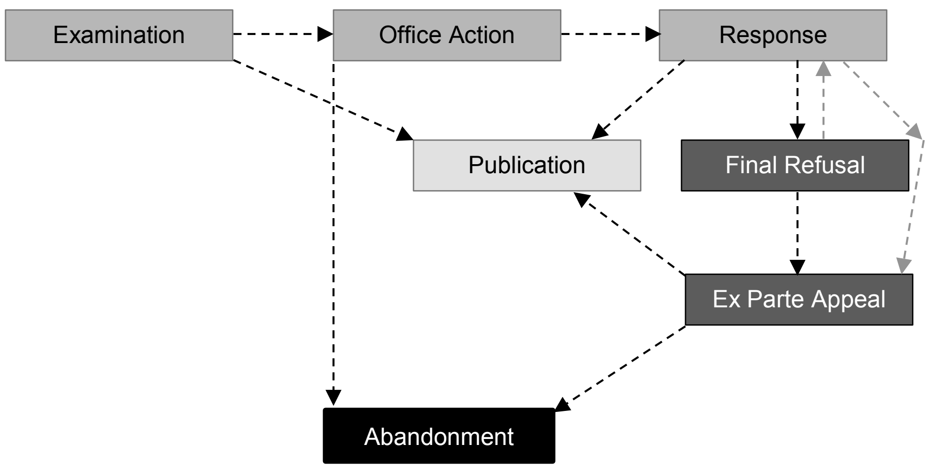
- Intent-to-Use (ITU) in U.S. Commerce
- Convention Priority based on non-U.S. Application
- Use in U.S. Commerce
- Non-U.S. Registration from Applicant's Country of Origin
- Request for Extension of Protection (REP) under Madrid Protocol

Registration bases include:

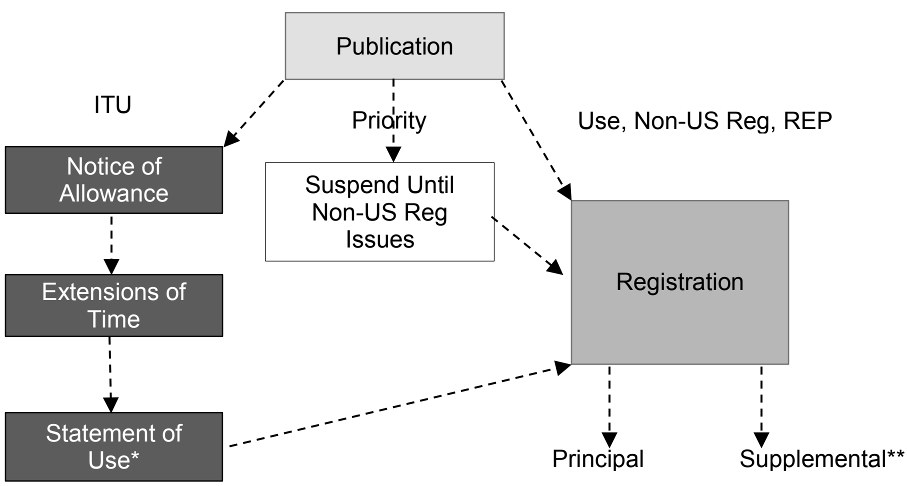
- Use in U.S. Commerce
- Non-U.S. Registration from Applicant's Country of Origin
- REP under Madrid Protocol

A diagram of the application process is set out below:

The Application Process



The registration process differs depending upon the basis of the U.S. application.



*Must be filed within 3 years of issuance of Notice of Allowance
**Not available for REPs

3. Term of Protection

Provided a trademark is in use and the registration is renewed, trademark rights can last forever.

Below is a chart showing the trademark renewal terms in key jurisdictions. In certain jurisdictions, terms are measured from the filing date of the application, whereas in others, the term is measured from the registration date. Therefore, your company should confirm the term of its trademark registration with local counsel.

Country	***Renewal Term***
Argentina	10 years
Australia	10 years
Brazil	10 years
Canada	15 years* (may change after new laws enacted)
China	10 years
EU	10 years
France	10 years
Germany	10 years
Italy	10 years
Japan	10 years
Mexico	10 years
Russia	10 years
Spain	10 years
UK	10 years
U.S.	10 years (Affidavits of Use must be filed at 6th-year anniversary of registration date as well as with each renewal)

D. Patents

1. Considerations on Filing Strategies

When developing a strategy as to where to file for your company's patents, filings generally should be made in countries where:

- your company has significant sales/license revenue;
- your company manufactures the product;
- your competitors are based; and
- counterfeiters operate.

In addition to where to file for patents, how to file for your company's patents must be considered. Options include:

- **filing with a claim of priority under the Paris Convention**: As with trademarks, the Paris Convention is applicable in relation to patents. If priority is being claimed in relation to an *application or registration for a design* (*e.g.*, a Registered Community Design), the priority window is six months from the filing date of the original application for the design. If priority is being claimed in relation to a *utility patent application or registration*, the priority window is one year from the filing date of the original patent application.

- **for U.S. companies filing for utility patents**: your company can file a U.S. provisional patent application, which is a short form of a patent application that acts as a placeholder until a U.S. non-provisional or utility application is filed. The non-provisional application must be filed within one year of the filing date of the provisional application. Usually, concurrently with the filing of the U.S. utility application, a Patent Cooperation Treaty (PCT) application is filed.
- **filing a PCT**: The PCT, an international patent law treaty with 148 signatories (as of 4 September 2014), offers a unified procedure for filing patent applications to protect inventions in each of the contracting states. A patent application filed under the PCT is generally referred to as a PCT application. Your company has 12 months from the original national patent application to file a PCT application. After filing a PCT application, your company then has 18 months from that date to file national applications in any or all of the PCT contracting states. Key jurisdictions that are not signatories to the PCT include Argentina and Taiwan. Priority will date back to the filing date of the original national patent application.
- **The European Patent Convention (EPC)**: The EPC is a treaty administered by the European Patent Organization (EPO) under which European patents are granted. Patent applications filed at the EPO are prosecuted at the EPO. If granted, however, these patents must be validated by the EU national patent offices in order to become effective. As the EPO has already granted the patent, as a practical matter the validation process is merely an administrative formality.
- **Europe: Unitary European Patent System**: Companies will soon be able to protect their creations on the Community level. Regulation (EU) No. 1257/2012 was adopted by the European Parliament on 17 December 2012 and came into force on 20 January 2013 but will become applicable only once the agreement for a unified patent jurisdiction comes into force. Unitary patents will be filed as a European patent covering the territory of the EU (with the exception of Italy and Spain). Once the Unitary European Patent System comes into effect, it will no longer be necessary to validate the European patent into specific countries through the filing of translations and payment of fees. Rather, the European patent will be accepted in English, French or German and will be enforceable in all participating countries after payment of a single renewal fee.

2. Registration Process

As mentioned earlier in this chapter, registration is required in order to obtain patent protection.

To register a patent, one usually begins by filing an application with the Patent Office in each country or jurisdiction (*e.g.*, the EU) in which registration is sought. As mentioned above, other filings may be performed through PCT applications.

The application will need to contain at least the following information:

- the name of the inventor (or claiming entity, where permitted);
  In a number of countries, like the U.S., the inventor(s) must apply for the patent and then it may be assigned to the company (such as the employer of the inventor(s)). It is imperative your company have proper agreements (such as **Invention Assignment**

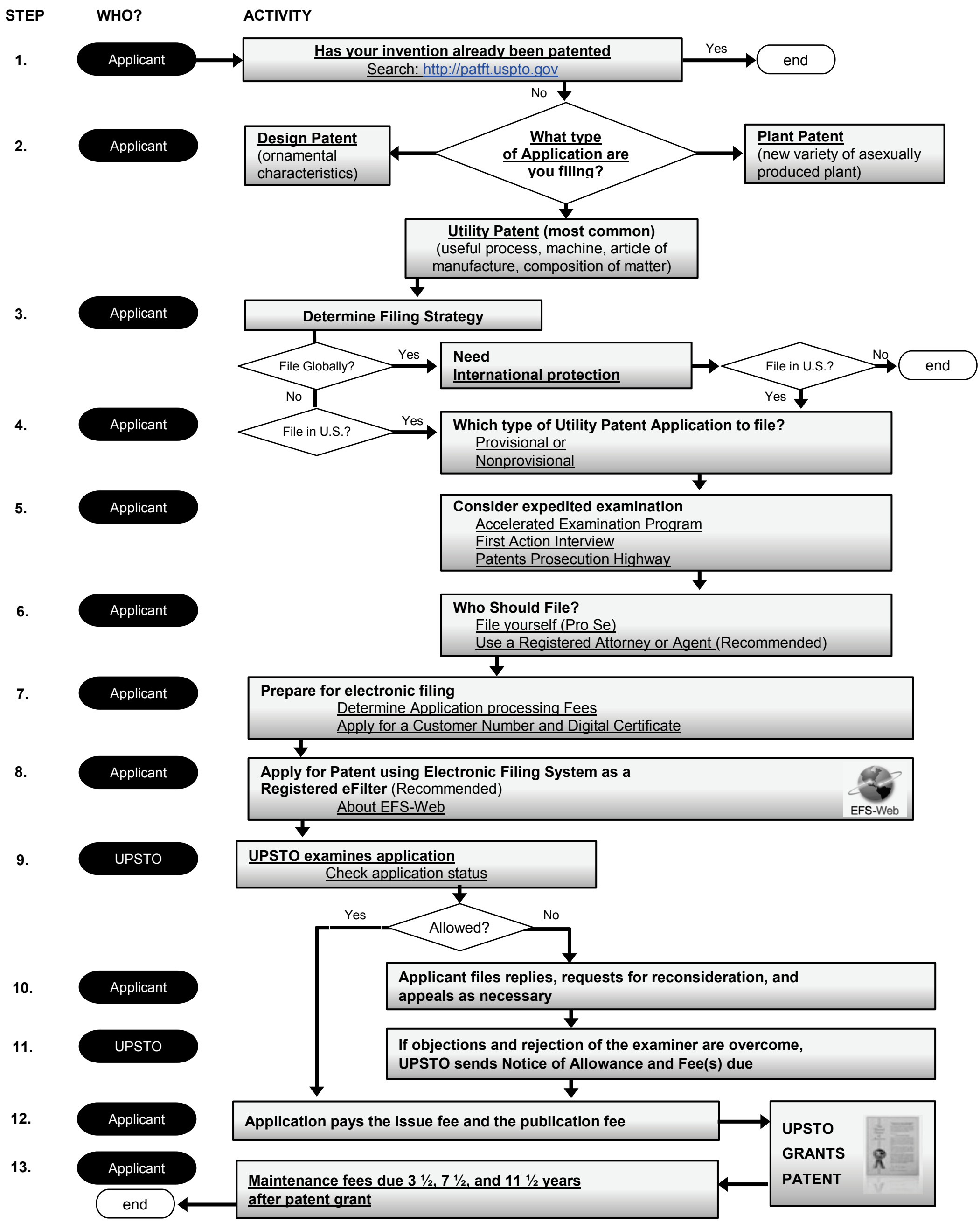
Agreements) in place to ensure such a transfer is required and made in a timely fashion; otherwise, rights in the patent could be lost or mired in litigation that may be required to effect the transfer.

- drawings and/or descriptions of the invention (often referred to as the "claims"); and
- particulars of priority application(s) (and possibly a certified copy of the application) if Paris Convention priority is being claimed.

Generally speaking, the prosecution process is as follows: after the application is examined, it will either be approved or an official action from the Trademark Office will issue. In certain jurisdictions, such as the U.S., an examiner conducts substantive reviews of the claims, analysis of prior art, etc., and issues formal refusals. Once all objections raised in the official action are resolved, the application will be approved. Appeal and opposition procedures are also generally available, either *ex parte* or *inter parte*. While oppositions are currently not available in **France** or **Italy**, challenges to the validity of a patent can be brought as cancellation proceedings before the competent court. Moreover, in **Argentina**, after three years dating from the grant of the patent or four years from the filing of the application, any person is entitled to request from the INPI an authorization to use the invention without the patentee's authorization (compulsory license) if the invention has never been used or if its use has been interrupted for more than one year, except in case of force majeure or lack of effective preliminary steps for using the patented invention.

The registration process differs from country to country. Detail regarding the patent registration processes around the globe is outside the scope of this chapter, and we recommend local counsel be consulted in relation to filing and registration of patents in your company's countries of interest.

For the U.S., below is a flowchart depicting the basic registration process for a U.S. patent application filed with the USPTO.


STEP
WHO?
ACTIVITY
1.
Applicant
Has your invention already been patented
Search: http://patft.uspto.gov
Yes
end
No
2.
Applicant
Design Patent
(ornamental characteristics)
What type of Application are you filing?
Plant Patent
(new variety of asexually produced plant)
Utility Patent (most common)
(useful process, machine, article of manufacture, composition of matter)
3.
Applicant
Determine Filing Strategy
File Globally?
Yes
Need International protection
File in U.S.?
No
end
No
Yes
4.
Applicant
File in U.S.?
Yes
Which type of Utility Patent Application to file?
Provisional or
Nonprovisional
5.
Applicant
Consider expedited examination
Accelerated Examination Program
First Action Interview
Patents Prosecution Highway
6.
Applicant
Who Should File?
File yourself (Pro Se)
Use a Registered Attorney or Agent (Recommended)
7.
Applicant
Prepare for electronic filing
Determine Application processing Fees
Apply for a Customer Number and Digital Certificate
8.
Applicant
Apply for Patent using Electronic Filing System as a Registered eFilter (Recommended)
About EFS-Web
EFS-Web
9.
UPSTO
UPSTO examines application
Check application status
Yes
Allowed?
No
10.
Applicant
Applicant files replies, requests for reconsideration, and appeals as necessary
11.
UPSTO
If objections and rejection of the examiner are overcome, UPSTO sends Notice of Allowance and Fee(s) due
12.
Applicant
Application pays the issue fee and the publication fee
UPSTO GRANTS PATENT
13.
Applicant
end
Maintenance fees due 3 ½, 7 ½, and 11 ½ years after patent grant

3. Term of Protection

The terms of patents vary depending on the type of patent. Below is a chart showing the patent terms in key jurisdictions. Maintenance fees are often required to maintain patents. In order to discourage owners from maintaining patents that are of little commercial interest, these fees become progressively higher throughout the length of the patent term. In many, but not all, cases, the term is measured by the filing date of the application. Your company should verify the terms of its patents with local counsel in the relevant jurisdictions.

Country	***Term***
Argentina	20 years from filing date; 10 years from filing date for utility models
Australia	20 years for standard patents; 8 years for innovation patents
Brazil	20 years from filing date for an invention patent; 15 years from filing date for a utility model
Canada	20 years from filing date for patents filed on or after 1 October 1989
China	10 years for design patents
France	20 years from filing date
Germany	20 years from filing date; 10 years for utility models
Italy	20 years from filing date for industrial inventions; 10 years from filing date for utility models
Japan	20 years from filing date
Mexico	20 years from filing date
Russia	20 years from filing date for an invention; 10 years from filing date for an utility model; 15 years from filing date for an industrial design
Spain	20 years from filing date
UK	20 years from filing date
U.S.	20 years from filing date for utility patents; for design patents: 14 years from date of issuance if application filed prior to 18 December 2013; 15 years from date of issuance if application filed on or after 18 December 2013

E. Domain Names

Domain names are registered through domain name registries or re-sellers such as Network Solutions, GoDaddy, etc.

IV. Enforcing Your IP Rights

The forms of IP protection outlined above are enforceable against any third party making an unauthorized use of the protected IP. The following actions are generally utilized to protect and enforce each form of IP:

- cease and desist letters
- administrative proceedings and remedies (*e.g.*, oppositions, invalidation hearings, cancellation actions, etc.)
- injunctions
- civil lawsuits
- criminal lawsuits (where possible)
- partnering with local customs authorities to seize counterfeit goods

Beyond the scope of IP protection, designers will also want to prevent competitors from unfairly using their investments, reputation and know-how. In addition to infringement claims, in certain jurisdictions such as Australia, China, Germany, Italy, Japan, the UK and, to a limited degree, the U.S., unfair competition and/or passing off claims may serve as additional grounds for recovery.

While the enforcement methods are substantially the same, the scope of protection differs between the various rights. As Chapter 2 will focus on details of enforcement of IP assets, we provide below only general information relating to enforcement options in each of the listed countries.

The elements for infringement and available defenses differ from country to country. Also, an action can be brought against someone who groundlessly threatens legal proceedings in relation to a purported copyright infringement, so care should be taken before threatening legal action. Accordingly, prior to taking any action, counsel should be consulted in cases where your company believes an infringement has occurred or your company is being accused of infringing another's IP rights.

A. Copyrights

Generally speaking, copyright infringement occurs when a third party violates the exclusive rights of the copyright owner (detailed in the *Types of IP - Copyrights* section). In a limited number of jurisdictions, defenses such as fair use, copying for private use, etc., may be available. Below are additional details in relation to courts that hear infringement cases and the infringement remedies that are available in key jurisdictions.

Argentina

Civil courts and criminal courts are entitled to hear copyright infringements.

The civil procedure may take approximately four to six years to reach a final decision.

It is also possible to obtain an injunction against an infringing party for copyright infringement.

Australia

Copyright cases in Australia are usually heard in the Federal Court and compensatory damages for infringement are the primary remedy used. A copyright owner can claim damages for conversion in conjunction with compensatory damages for infringement. Damages are generally measured in reference to the value of the infringing copy at the date of conversion. The court has a discretion to take into account expenses incurred by the defendant and the proportion of copyright material in the infringing article. If a good comprises infringing and non-infringing material, the value of the converted good for the purpose of damages depends on whether the goods can be severed into infringing and non-infringing parts.

Where it is established that the defendant was not aware (and had no reasonable grounds for suspecting) that their actions constituted an infringement of copyright, then damages cannot be awarded, although the court can still order an account of profits. In practice, defendants rarely succeed in establishing this innocence defence.

The courts also have enhanced powers to grant relief to copyright owners in civil actions involving commercial-scale online infringement. They can take into account likely infringements as well as proved infringements in deciding whether an infringement was of a “commercial scale” and what relief to grant.

Brazil

Enforcement options include:

Injunctions: IP right owners may obtain injunctions against infringers ordering infringers to cease the manufacturing, launching, use, reproduction, offering for sale, sale or import of the infringing products in the market, either to prevent irreparable harm caused by the infringement and the delay in having a final court decision, or to anticipate the effects of the final decision in view of strong evidence that the plaintiff’s claim is well founded. In both cases, strong evidence of the alleged infringement and of potential irreparable harm to the plaintiff must be submitted to the judge.

Civil Lawsuit: A lawsuit can be filed against the infringing party, seeking: (i) discontinuance of any unauthorized use of the corresponding IP right; (ii) imposition of a fine for noncompliance with the discontinuance of the use thereof; and (iii) compensation for losses and damages caused by the infringing acts.

Crimes against Industrial Property and Unfair Competition: Certain conduct, such as the unauthorized use or reproduction of products/processes protected by IP rights, is also defined as a crime under local IP laws. Penalties range from imprisonment of one month to one year, plus a fine. The IP law also treats as crimes certain unfair competition practices, such as the disclosure or employment of fraudulent means or false statements for the purpose of obtaining an advantage vis-à-vis a competitor, deliberate misleading of consumers, and other fraudulent acts. The IP law provides for a penalty of imprisonment of three months to one year, or a fine. In such crimes, the prosecution of the infringer depends on the request of the owner of the violated rights.

Canada

Interestingly, in Canada, a copyright owner will lose her his or right to enforce copyright in a design applied to a useful article if, with the owner's consent, the article is reproduced in a quantity of more than 50, unless it falls within a stipulated exception. Because of this significant exception for mass-produced articles, copyright may not be as effective as other IP such as trademark and industrial designs.

In relation to luxury goods, the two most relevant forms of infringement are direct and secondary infringement.

Direct Infringement

A person infringes copyright when he or she does anything that falls within the exclusive right of the copyright owner. Direct infringement of copyright is a matter of strict liability – that is, intention to infringe or knowledge of infringement is not required to establish direct infringement. Direct infringement exists where there is sufficient substantial similarity between the original work and the infringing copy.

Secondary Infringement

Secondary infringement exists where a person sells, rents out, distributes, exposes or offers for sale or rental, or exhibits in public, unauthorized copies of copyrighted material, or possesses or imports into Canada unauthorized copies of copyrighted material for the purposes of doing any of these things. The accused must know, or ought reasonably to have known, that he or she is dealing in unauthorized copies; though, in the instance of an importer, his or her knowledge is irrelevant.

Remedies can be sought under the Copyright Act in either the Federal Court or in provincial courts. The breadth of jurisdiction under the federal courts, however, is more limited than the provincial courts. For example, the Federal Court lacks jurisdiction to hear cases involving breach of contract, licensing disputes and negligent misrepresentation – though it can hear such matters if a contract dispute is supplemental to copyright infringement.

Copyright infringement is most often dealt with by way of an action. Interim remedies, such as an interlocutory injunctions, are also available. Available civil remedies include injunctions, damages *and* accounting of profits,[12] delivery up and declaration. A copyright owner may seek statutory damages in lieu of general damages, but must elect this remedy before trial. The amount of statutory damages will depend on whether the infringement is related to commercial or non-commercial purposes. For example, where infringement is for commercial purposes, statutory damages are set at not less than $500 and not more than $25,000, with respect to all infringements involved in the proceedings for each work or subject matter infringed (not for each copy). However, if the defendant was not aware and had no reasonable grounds to believe that it had infringed copyright, the court may reduce the amount to less than $500, but not less than $200. Where infringement is for non-commercial purposes, statutory damages are set at not less than $100 and not more than $5,000 for all works or other subject matter.

[12] This opportunity for both remedies is distinguished from that available under patent or trademark infringement, where damages and profits are mutually exclusive remedies.

If successful at trial, a copyright owner will be automatically entitled to a permanent injunction, subject to any equitable defenses. A moral rights holder may seek all remedies at law for infringement.

If the copyright owner proves infringement, damages, which are at large, are presumed to exist. Where actual damages cannot be proven, nominal damages, which are not necessarily trifling, may be awarded. Aggravated damages may also be provided, to enhance the plaintiff's compensation where the defendant's malice or misconduct injured the plaintiff's feelings of dignity and pride.

Punitive damages may be awarded in egregious cases and only where general and aggravated damages would not suffice to achieve the goal of punishment and deterrence.

China

At the local level, the Bureau of Culture, Broadcasting and TV (the exact name varies in different cities) is responsible for administrative enforcement of copyright. Copyright owners may lodge complaints with the authorities for copyright infringement. Local enforcement authorities are authorized to order cessation of infringing acts, confiscation of unlawful income, confiscation and destruction of infringing reproductions, and the imposition of fines. In serious cases, they can also confiscate the materials, tools, equipment, etc., used for the manufacture of the infringing reproductions. The Copyright Implementing Regulations, amended in 2013, empower local enforcement agencies to fine infringers up to five times the revenue generated from the illegal transactions, or up to RMB250,000 in cases where the revenue cannot be calculated.

Under the Copyright Law, copyright owners can apply to the People's Courts for a preliminary injunction against an act of infringement and for a property preservation order. Upon a finding of infringement, violators are required to pay damages based on the owner's actual losses. Where such actual losses are difficult to calculate, damages may be based on illegal income earned by the infringer. The damages should also include reasonable expenses incurred in halting the infringing act, including legal and investigation costs. Where the rights owner's damages or the infringer's profits cannot be determined, the Copyright Law provides for the payment of statutory damages up to RMB500,000. The latest draft amendment to the Copyright Law has increased this amount to RMB1 million.

Where the amounts of illegal income involved are "relatively large" or where other "serious circumstances" exist, prison terms of up to three years may be imposed for certain acts of copyright infringement, such as the reproduction and distribution for profit of literary, musical, film, television, video recordings, computer software, or other copyrighted works, without the permission of the copyright holder.

France

Copyright infringement exists when the infringing work reproduces the copyrightable parts, *i.e.*, the essential characteristics of the protected work. Copyright infringement is determined by taking into account the resemblances and not the differences.

Thus, if the infringing work reproduces elements that are banal or common in the fashion industry, correspond to a fashion trend insusceptible of appropriation, or only respond to technical necessity, there will be no copyright infringement. On the contrary, where the original features of the creation are reproduced, so that the litigious creation only departs from the protected work by minor alterations that do not allow the designs to be distinguished, there will be copyright infringement.

Fashion and luxury goods designers tend to combine copyright protection with design protection, by registering their design and then relying on both the design and copyright protection in litigation proceedings.

Design registrations provide owners with an exclusive right over the design, including the right to manufacture, offer, market, import, export, use or detain the product incorporating the design. The exercise of any of these rights without authorization of the owner amounts to design infringement.

Copyrights, designs, trademarks and patents rights may be enforced by means of both criminal and civil (including provisional remedies) measures, including:

- *Summary Proceedings* (*référés*) – where an injunction may be sought for infringement. The granting of an interim injunction does not preclude the award of a final injunction if an action on the merits is thereafter initiated.
- *Civil Action on the Merits* – where the plaintiff can initiate an IP right infringement action on the merits before the competent civil courts of first instance and claim for the following remedies:
  - *Injunctions*: destruction, removal of infringing products, recall of infringing goods from the market, publication of the court's decision; and
  - *Damages*, which may only be compensatory, as opposed to punitive.
- *Criminal Action* – IP infringement may also give rise to criminal prosecution. Criminal enforcement in the context of fashion and luxury goods designs infringement represents a very effective and relatively inexpensive tool. Indeed, the infringing goods are quickly removed from the market, with immediate economic pain inflicted on the infringer. Criminal courts (as opposed to civil courts) do not specialize in IP and thus it is better to resort to criminal action for straightforward trademarks cases only, where the trademarks at issue are either identical or very close.

Germany

German law allows the infringed party to claim recovery of legal costs from the infringer in the case of cease and desist claims.

The German Copyright Act provides for a claim for injunctive relief and, in case of intent or negligence, for damages and criminal law sanctions as well.

The German legal system is relatively right-owner friendly and provides efficient remedies in relation to the protection and enforcement of IP rights. The competent courts are specialized and experienced in IP matters.

Under the relevant German IP laws, the infringed party is entitled to cease and desist and damage claims against the infringer, as well as, partly, to claims for destruction of infringing products. The infringed party may request the disclosure of relevant information, such as sales figures and profits, in order to calculate its damages. The infringed party is entitled to claim damages that can be calculated on the basis of either the infringer's profits, the lost profits of the IP owner or license analogy.

Preliminary injunction proceedings are a very effective and a fast way to protect IP rights against actual or threatening typically infringements. Preliminary injunction proceedings are usually *ex parte*, and a decision usually issues within a period of four days. Preliminary injunction proceedings are only admissible if the matter is urgent. A matter will usually not be deemed to be urgent if more than about four weeks have passed since the infringed party has gained knowledge of the infringement. In most cases, it is advisable to send out a warning letter to the infringer before applying for a preliminary injunction.

Under German law, the infringed party has a claim against the infringer for recovery of legal costs. Depending on the value of the case, such cost reimbursement claim might cover a significant part of the lawyer's fees for the warning letter, as well as of the legal costs of preliminary injunction and main proceedings.

Italy

The Copyright Law grants the author of a work both moral and economic exclusive rights. Moral rights consist of both the right to be identified as the author and to object to possible distortions or mutilations of the work that could be prejudicial to the author's reputation. Economic rights consist of a number of faculties to exploit the work, including the right to reproduce it, to perform it in public, to communicate it to the public, to disseminate it, to translate it, to rent it, etc. Each of these rights is independent and the exercise of any of them by an unauthorized individual triggers copyright infringement. However, the test for infringement depends on the relevant infringed right. With reference, *e.g.*, to the exclusive reproduction right, the unauthorized copying of all or part of the protected work is in principle considered to be copyright infringement. Accordingly, the infringement of designs of fashion and luxury goods requires that at least a substantial part of the work is copied.

Generally speaking, the owner of a trademark, design, patent or copyright can pursue infringers of its exclusive rights by both civil enforcement measures, including provisional remedies, as well as by criminal enforcement procedures. In both civil and criminal actions, the IP owner has the burden to prove the existence, but not the validity, of the enforced IP right, as well as the existence of an infringement. For unregistered rights such as copyright, the existence of a registration in another country or of a foreign court's decision recognizing the existence and validity of copyright on the relevant design/product, may be used before an Italian court as circumstantial evidence of the exclusive rights in the design, although judges may discretionally decide on their admissibility and/or relevance.

Japan

Copyright protection in Japan will allow the owner of the copyright to take action against third parties who have copied a substantial part of the copyrighted work without the owner's consent. However, in relation to the applied art or industrial design, the scope of protection is fairly narrow.

Mexico

Unauthorized users may be subject both to damages and criminal penalties. Evidence from other countries can be used as an exception solely in copyright infringement.

Russia

The exclusive right to an IP asset belongs to its right holder and essentially means that only the right holder is entitled to use (and authorize third parties to use) the asset in question at its discretion in any legitimate manner.

Russian civil proceedings allow general remedies for all types of IP, such as claims aimed at: recognition of the IP owner's right; preventing actions infringing or creating a threat of infringement of another's right; damages; seizure of goods; and publication of the judicial decision on the infringement committed.

There also are specific remedies, which vary depending on the type of infringed IP right.

Spain

IP rights may be enforced either by civil or criminal actions filed before the Spanish courts. Criminal actions are brought in cases of identical or almost identical copies of the protected goods (counterfeits). Civil actions are brought with respect to infringements. Requests for interim injunctions are also available. Remedies include cessation of the infringing acts, compensation for damages, adoption of measures necessary to avoid the continuation of the infringement (in particular, the withdrawal of the infringing product and other commercial or advertising documents or materials from circulation), destruction or transfer for humanitarian purposes of the infringing products, and the publication of the decision at the expense of the infringing party.

There is now an administrative procedure in Spain regarding copyright infringement on the internet. This procedure is processed through the Spanish Intellectual Property Commission, which is a part of the Spanish Ministry of Education, Culture, and Sports. As a result of this procedure, the Intellectual Property Commission may order the closing of the internet services provider. However, the enforcement of the commission's decisions must be ordered by the relevant Spanish court. The commission's objectives are mainly to stop copyright infringement on the internet.

U.S.

In order to succeed in an infringement action, a plaintiff must prove ownership of a valid copyright and that the defendant copied the original elements of the copyrighted work. For the copying to be actionable, the defendant's work must be substantially similar to the copyrighted material. Generally, a plaintiff proves copying through circumstantial evidence, *i.e.*, by showing the defendant had access to the copyrighted work, and that there is a substantial similarity between the accused and copyrighted works.

Section 501 of the U.S. Copyright Act states that "anyone who violates any of the exclusive rights of the copyright owner ... is an infringer of the copyright or right of the author." As mentioned in the *Types of IP - Copyrights* section, these exclusive rights include the right to:

- reproduce the work in copies;
- prepare derivative works based upon the work;
- distribute copies of the work to the public by sale or other transfer of ownership, or by rental, lease, or lending;
- perform the work publicly; and
- display the copyrighted work publicly.

Generally, under the law, one who engages in any of these activities without obtaining the copyright owner's permission may be liable for infringement. However, there are several limitations of the exclusive rights of the copyright owner. The copyright law provides exemptions from infringement liability by authorizing certain uses in certain circumstances. The most relevant exemption for the purposes of this chapter is the fair use of a copyrighted work, including such use by reproduction in copies for purposes such as criticism, comment, news reporting, teaching (including multiple copies for classroom use), scholarship or research. In determining whether the use made of a work in any particular case is a fair use, the following factors are considered:

i. the purpose and character of the use, including whether such use is of a commercial nature or is for nonprofit educational purposes;
ii. the nature of the copyrighted work;
iii. the amount and substantiality of the portion used in relation to the copyrighted work as a whole; and
iv. the effect of the use upon the potential market for or value of the copyrighted work.

Remedies and damages for copyright infringement include injunctions, impounding and disposition/destruction of infringing articles, damages (including statutory damages or the copyright owner's actual damages and any additional profits of the infringer), costs and attorney's fees. Regarding statutory damages, these can range from $750 to $30,000 per work infringed or, in the case of willful infringements, a court has the discretion to award damages up to $150,000 per work infringed.

In relation to on-line infringements, a section of the Copyright Act commonly referred to as the Digital Millennium Copyright Act (DMCA) allows copyright owners to issue take down notices to the hosting companies/internet service providers responsible for websites that contain copyright-infringing content. In many cases, once having received take down notices, these entities will remove the infringing material or disable the website, in order to avail themselves of the DMCA's safe harbor provision (which permits such entities to avoid direct or secondary liability for copyright infringing material).

B. Industrial Designs/Designs

Generally speaking, a registered design is infringed if a person, without the license or authority of the registered owner, makes a product, in relation to which the design is registered, which applies the design or a very similar design, or commercially exploits such a product, by, *e.g.*, importing it into a country for sale, or selling, renting or using it for purposes of trade or business. Infringement will be found where the design is either identical or substantially similar to the registered design. (See the *Types of IP - Trademarks and Service Marks* section for additional details in relation to the rights and scope of protection afforded to the various types of designs in each particular jurisdiction.) Below are additional details in relation to courts that hear infringement cases and the infringement remedies that are available in key jurisdictions.

Australia

The only person entitled to bring an infringement action is the registered owner. Licensees may not do so. Infringement actions are brought in the Federal Court. Although the Federal Court has the powers described above in respect of trademarks, it also has the discretion to refuse to award damages or an account of profits if the defendant was not aware that the design was registered and had taken all reasonable steps to find out if it was registered.

There are no provisions under the Designs Act to award additional damages for flagrant infringement.

Brazil

See the *Enforcing Your IP Rights - Copyrights* section above.

Canada

An action for infringement of an industrial design may be brought in any court of competent jurisdiction by the proprietor of the design or by an exclusive licensee of any right therein, subject to any agreement between the proprietor and the licensee.

Infringement is determined by considering: (a) whether one design would actually be confused with the other; (b) whether the infringing article would have any existence vis-à-vis design but for the registered design; and, (c) whether the infringing article is closer to the registered design than any other prior designs. The court can look at previous designs of other similar articles to help determine if the differences between the original design and the allegedly infringing design are small or large. Infringement will only be found where essential features are, or the totality of the design is, substantially taken.

Remedies for infringement include interim remedies, such as seeking custody or preservation of material that will be the subject of the trial, if it appears the defendant will destroy or remove the infringing articles from the jurisdiction. This interim remedy is typically sought via an Anton Pillar order. A Mareva injunction may also be sought to prevent transfer of assets outside the jurisdiction. Civil remedies such as injunctions and/or damages (*e.g.*, recovery of damages *or* profits, punitive damages, and the disposal of any infringing article or kit) are also available.

Note that if the defendant can prove that he or she was not aware and had no reasonable grounds to suspect that he or she was using a registered design, the only available remedy will be injunction. The plaintiff will, however, not be limited to this remedy if, at the time of the infringement, it had marked its articles or their packages or labels as provided by the Industrial Design Act, which would include a capital "D" in a circle and the name or usual abbreviation of the name of the proprietor.

EU

Community designs have a unitary character and an equal effect throughout the Community: thus, Community designs infringement claims apply to the entire territory of the EU.

Community designs protection may be enforced by means of civil (including provisional remedies) measures, and, depending on the national legislations of each member state, by means of criminal measures. Jurisdiction in relation to infringement of Community designs lies exclusively with the Community designs courts designated by each member state.

In terms of sanctions, the Community designs courts may order prohibition and seizure injunctions, as well as any other sanctions, including damages, allowed under the national law of the member state where the infringing acts were committed.

France

See the Copyright section for France for enforcement options.

Germany

See the Copyright section for Germany for enforcement options.

Italy

In addition to the methods of recourse detailed in the Copyright section for Italy, the recourse to criminal enforcement to protect designs of products in the fashion and luxury field represents a very effective, rapid and relatively inexpensive tool: infringing goods are quickly removed from the market, with immediate economic pain inflicted on the infringer. Criminal enforcement is carried out directly by the Italian Tax Police (*Guardia di Finanza*), which has powers to make test purchases, enter the infringer's premises and seize the infringing goods. The Tax Police may intervene both upon the right holder's notice – and, in this case, the right holder can take part in the police's initiatives – or *ex officio*.

Japan

Successful plaintiffs (design owners or registered exclusive licensees) are entitled to the following remedies for infringement: injunctions, destruction of goods/equipment used to produce the goods; and monetary damages, including (1) loss of profits to the plaintiff due to the infringement (2) defendant's profits due to the infringement and (3) a royalty amount that the defendant should have reasonably paid so as to have avoided the infringement. Note that in Japan there is no concept of treble damages or punitive damages.

Russia

Any use of a design without the right holder's permission is deemed illegal and may be subject to a civil and/or criminal action, or is punishable in accordance with the administrative laws.

See Copyright section for Russia regarding enforcement options.

Spain

Infringers are liable for damages caused, provided they have received sufficient warning from the trademark design owner. Therefore, it is advisable to send a cease and desist letter to the infringer before filing any court action, in order to confirm they are aware of the infringement and their obligation to pay damages.

See Copyright section for Spain regarding additional enforcement options.

UK

In its simplest form, the test for design infringement is whether, when compared side by side, the designs create the same overall impression on the informed user. As such, the greater the novelty of a design, the wider the scope of protection.

Infringement of a UK-registered design will occur when a person, whether knowingly or intentionally, copies a registered proprietor's exclusive right to such an extent that it produces the same overall impression on the informed user, taking into account the freedom of the designer. Under UK law, an infringement will include when a third party makes, offers, puts on the market, imports, exports, stocks or uses such a product without the owner's consent.

There are a number of exceptions provided for in relation to UK-registered designs that will not constitute infringement. These include acts done privately and for non-commercial purposes, for experimental reasons or for teaching purposes (provided the reproduction is fair and not unduly prejudicial), and if the product has previously been put on the market in the European Economic Area (EEA) by or with the consent of the owner (under the doctrine of exhaustion).

For a successful claim of registered designs infringement, the following remedies will be available:

- damages or an account for profits;
- an injunction to future infringements;
- an order for delivery up or destruction of the infringing article.

C. Trademarks and Service Marks

Trademark infringement generally occurs when a third party uses a mark that is identical or confusingly similar to another's on goods or services that are identical or highly related. (see the *Types of IP - Trademarks and Service Marks - What rights does it confer upon the owner*? section). In a limited number of jurisdictions, defenses such as fair use and comparative advertising may be available. Below are additional details in relation to courts that hear infringement cases and the infringement remedies that are available in key jurisdictions.

Argentina

Trademark infringement actions may be brought in civil or criminal courts. Provisional remedies or preliminary injunctions to investigate the infringement of a trademark are available. If a settlement with the infringer is not reached within 15 working days after the preliminary injunction is executed, a civil or criminal court action must be filed. There is a compulsory pre-trial mediation process to attempt to settle the matter. If the parties fail to reach an agreement, the party who requested the mediation can initiate a court action seeking to enforce its rights in a Federal criminal court.

The Procedural Code of the city of Buenos Aires establishes that a mediation hearing is mandatory before initiating a lawsuit in court. However, the Procedural Codes of the province of Buenos Aires and the rest of the provinces in Argentina do not have any provisions regarding mediation hearings. As such, in Argentine provinces (as opposed to the city of Buenos Aires), lawsuits are initiated without an prior mediation. Criminal actions do not require a prior mediation hearing.

Australia

Enforcing non-traditional trademarks can prove difficult in Australia, when imitators use the infringing sign as an embellishment and not to indicate the source of origin. The reputation developed by trademarks used in connection with fashion items and luxury goods can also be a downfall when enforcing registered trademarks against signs that are not identical to them, or when imitators only copy the get-up but include a very different word mark. Australian courts have found that consumers of a famous trademark are so familiar with all the elements that form the brand that they are unlikely to be confused or deceived by an imitator's products that do not reproduce all the brand elements or use a word mark that is only slightly or not at all similar to the famous mark.

Unless notice to an infringer would be obviously detrimental, it is usual and cost-effective to attempt to enforce trademark rights by first sending a letter of demand. Costs cannot generally be demanded until after proceedings have commenced. Demand letters must be carefully framed, as there are provisions in the Trade Marks Act by which a person aggrieved by a groundless threat of legal proceedings can obtain damages.

Infringement cases are generally brought via civil action in the Federal Court or in the Supreme Court of a state or territory. The Federal Circuit Court is also able to hear less complex trademark matters. In practice, most proceedings are brought in the Federal Court.

Trademark owners can seek the following preliminary orders:

- an interim injunction to put a temporary stop to the allegedly infringing activities;
- a search order (also known as an Anton Piller order) for the inspection and preservation of premises, documents and articles pending trial;
- a freezing order (also known as a Mareva injunction) to stop the infringer disposing of assets or leaving the jurisdiction; and
- a Norwich Pharmacal order to find out the infringer's sources and customers.

A full range of permanent orders are also available, including injunctions to stop infringement, to hand over or destroy infringing goods, or to provide certain information, and orders for delivery up of infringing goods and the means of production. Corrective advertising can be ordered in certain cases.

The court may order that an infringer hand over the profits it has made as a result of its infringing activities. The plaintiff must make an choice between damages and this remedy. The principal disadvantage of an account of profits is the practical difficulty and cost (including that of employing expert accountants) of ascertaining the defendant's profits. However, this remedy is worthwhile if profits are likely to exceed damages. To claim damages, the plaintiff must prove the loss it has suffered as a result of the defendant's infringing acts. Damages may be available, for instance, to compensate for lost sales or damage to goodwill.

Brazil

See *Enforcing Your IP Rights - Copyrights - Brazil* section above.

Canada

A registered trademark gives the owner of that mark the exclusive right, throughout Canada, to use that trademark in connection with the goods and services for which the trademark is registered, and the right to prevent others from selling, distributing or advertising goods or services in connection with any other mark that causes, or is likely to cause, confusion with the registered trademark. The rights conferred by a registered trademark are deemed by statute to be infringed by the use of the same or any confusing trademark or trade name in association with the sale, distribution, or advertisement of another party's wares or services. A registered trademark is also a *de facto* defense against any action for infringement or passing off by another person.

Fashion designers often seek protection for distinguishing guise relevant to distinctive design elements in apparel, accessories and footwear, as this can extend to protect color, product shape, accessory configurations and distinctive stitching. Distinguishing guise protection extends to the shape of wares or their containers, or a mode of wrapping or packaging. Three-dimensional trademarks can be used to protect configurations, as found with perfume bottles and footwear. Color as applied to the surface of a product can also be used to provide trademark protection.

An owner seeking to enforce its trademark rights can seek remedy under any of (a) the Trademarks Act (in the Federal Court), (b) the provincial courts, or (c) the civil law in Quebec. Actions for remedies under the Trademarks Act are brought in the Federal Court. Proceedings may be commenced by way of application or action. An application is an abbreviated proceeding that is summary in nature and more expeditious than an action. Factors such as the remedy sought, credibility of witnesses, the need for discovery and the objectives of the trademark owner will determine which procedure is best to use. Different causes of action are available to owners of registered and unregistered marks, depending on the right being asserted and the conduct of the offending party.

Infringement of a registered trademark can be remedied by way of action or application in the Federal Court or the superior court of a province of Canada. Remedies include: declarations; permanent or interlocutory injunction; recovery of damages or profits; the destruction, exportation or other disposition of any offending goods, packages, labels and advertising material; and punitive damages. The court may order an interim custody of offending goods that have been imported into Canada or are about to be distributed in Canada, and may prohibit future importation of such wares.

China

Where an act of registered trademark infringement occurs, the trademark registrant or an interested party may pursue administrative or judicial actions. In certain cases, criminal liability may also be pursued.

Under recent amendments to the Chinese trademark law, the definition of acts of infringement have been expanded to include deliberately providing conditions beneficial to acts of infringement and helping third parties in acts of infringement.

Complaints to the Administrations for Industry and Commerce (AIC), seeking administrative remedies, may be filed by the registrant. If, after its investigation, an AIC determines that an infringement has occurred, it can impose an order requiring the infringer to immediately cease the acts of infringement, confiscate and destroy the tools of infringement and the tools primarily used to manufacture the infringing goods, and issue an administrative fine against the infringer. The Technical Supervision Bureaus (TSB) may also intervene in cases involving the production of counterfeits or other products that fall under the category of "fake and inferior products".

Civil litigation against trademark infringers in the People's Courts is another common alternative. It is noteworthy that the People's Courts in many cities have become increasingly generous in their compensation awards, prompting more companies to resort mainly to civil enforcement to protect their rights. In addition, the Chinese legislature has recently approved the set-up of special IP courts in Guangzhou, Shanghai and Beijing.

Damages can be awarded by courts based on the plaintiff's losses, the defendant's profits or trademark royalties. Where the foregoing amounts are difficult to determine, courts can award statutory damages up to RMB3,000,000. Where damages are claimed and the alleged infringer claims the trademark owner has not used the mark for three years, courts can ask for evidence of use. If the trademark owner cannot show use, or other losses caused by the infringement, no damages will be awarded.

Criminal enforcement of trademark rights is also available under the Criminal Code, under which the acts of trademark counterfeiting may constitute a crime if the circumstances qualify as “serious”. The defendant can be sentenced to up to three years’ imprisonment and/or be required to pay a fine. For circumstances that are “exceptionally serious”, the defendant may be sentenced to a maximum of seven years’ imprisonment and must pay a fine.

For import or export of infringing products, the PRC customs authorities may confiscate upon their arrival or departure from the PRC products that infringe registered trademarks, copyright or patents. Customs may also impose fines of up to 30 percent of the value of the infringing goods.

EU

Community trademarks have a unitary character and an equal effect throughout the Community: thus, Community trademark infringement claims apply to the entire territory of the EU.

Community trademarks may be enforced by means of civil (including provisional remedies) measures, and, depending on the national laws of each member state, by means of criminal measures.

The owner of a registered Community trademark has the exclusive right to prevent third parties from using (i) signs identical to the prior trademark for goods or services identical to those for which the prior trademark is registered; (ii) signs identical or similar to the prior registered trademark, for identical of similar goods or services, if they may create a likelihood of confusion in the public’s mind; and (iii) signs identical or similar to the registered trademark for dissimilar goods and services, if the registered trademark has reputation in the Community and if the subsequent sign takes unfair advantage of the distinctive character or of the reputation of the prior trademark or is prejudicial thereto.

Any of the above acts exercised in the course of trade and without consent of the owner amount to trademark infringement.

Jurisdiction for infringement of Community trademarks lies exclusively with the Community trademarks courts designated by each member state. Community trademarks courts may grant injunctions, as well as any other sanctions (including damages) provided for under the national law of the member state where the infringing acts were committed.

France

The owner of a registered trademark has the same exclusive rights as, and the standard for infringement of said rights is the same as, those discussed in the EU section.

See Copyright section for France regarding enforcement options.

Germany

Trademark infringement provides the owner of the mark with remedies including injunctive relief and disclosure and damages, if the infringement was undertaken intentionally or negligently. There are further ancillary claims for rendering of an accounting, destruction or the recall of infringing goods.

See Copyright section for Germany regarding additional enforcement options.

Italy

The owner of a registered trademark has the same exclusive rights as, and the standard for infringement of said rights is the same as, those discussed in the EU section.

In addition to the methods of recourse detailed in the Copyright section for Italy, the recourse to criminal enforcement to protect trademarks and designs of products in the fashion and luxury field represents a very effective, rapid and relatively inexpensive tool: infringing goods are quickly removed from the market, with immediate economic pain inflicted on the infringer. Criminal enforcement is carried out directly by the Italian Tax Police, which has powers to make test purchases, enter the infringer's premises and seize the infringing goods. The Tax Police may intervene both upon the right holder's notice – and, in this case, the right holder can take part in the police's initiatives – or *ex officio*.

Japan

Successful plaintiffs (trademark owners or registered exclusive licensees) are entitled to the following remedies for infringement: injunctions, destruction of goods/equipment used to produce the goods; monetary damages including (1) loss of profits to the plaintiff due to the infringement (2) defendant's profits due to the infringement and (3) a royalty amount that the defendant should have reasonably paid so as to have avoided the infringement. Note that in Japan there is no concept of treble damages or punitive damages.

Mexico

The standard for infringement in Mexico is that the infringing product must include a trademark, slogan or design that is confusingly similar to the registered right, such that consumer confusion results.

Infringers of another's trademark may be subject both to damages (including monetary fines) and criminal penalties.

Russia

Any use of a trademark without the right holder's permission is deemed illegal and may be subject to a civil and/or criminal action, or is punishable in accordance with the administrative laws.

When it comes to the protection of product trade dress, it is worth noting that registration of the whole packaging design as a combined trademark may not be sufficient protection from imitations and look-alikes. Rospatent and Russian courts usually recognize verbal elements (brands, etc.) in combined trademarks (registered labels and packaging) as dominant elements, and there is a risk that the courts would not find a trademark infringement in a product with trade dress reproducing graphical elements/combination of shapes and colors of your registered trade dress if a different word is used as a brand. Consequently, it is advisable for luxury goods producers to fortify protection of their packaging/labels by complementary registrations of separate design patterns, labels without brands/verbal elements, etc.

To establish whether there is an infringement, the court must consider the similarities between the trademark and the infringing designation, and the similarities between the goods with respect to which the infringed trademark is registered and the goods on which the infringing sign is applied. If the infringed trademark was recognized as well known in Russia, there is a good chance that the court will recognize an infringement also in the case of non-similar goods, provided there is a risk of association in the minds of consumers between said goods and the owner of the well-known trademark.

It is worth mentioning that, considering the importance and high value of brands in the luxury industry, it is quite tempting for entrepreneurs selling other, non-similar, goods to use a famous luxury brand and benefit from their appeal to consumers. Therefore, fashion and luxury goods companies at times have to challenge registrations and/or use by third parties of identical or confusingly similar trademarks used with other types of goods. This was done by watch producer Richemont International S.A. and its affiliate companies Manufacture Jaeger LeCoultre S.A. and Vacheron and Constantin S.A., which succeeded in canceling registrations and stopping use of the JAEGER-LeCOULTRE and VACHERON CONSTANTIN trademarks for clothes by third parties. This was a long battle, involving Rospatent and all court instances, but in its landmark ruling, the Supreme Arbitrazh Court of the Russian Federation relied on unfair competition and bad faith grounds and dismissed the defendants' dissimilarity of goods argument (watches versus clothes). Remarkably, the court specifically stressed the precedential nature of its decision.

See Copyright section for Russia regarding enforcement options.

Spain

Infringers are obliged to pay damages if they have received sufficient warning from the trademark owner. Therefore, it is advisable to send a cease and desist letter to the infringer before filing any court action, in order to confirm they are aware of the infringement and their obligation to pay damages.

See Copyright section for Spain regarding additional enforcement options.

UK

Trademark infringement will occur when a registered mark is being used in the course of trade without the owner's consent. The circumstances of infringement include when a third party adopts a mark that is either identical or closely similar to a registered mark, and is using that mark in relation to conflicting goods or services.

In the UK, the test for infringement is as follows:

	Identical Goods/Services	***Similar Goods/Services***
Identical Sign	Double identity – infringement	Is there a likelihood of confusion?
Similar Sign	Is there a likelihood of confusion?	Is there a likelihood of confusion?
Dissimilar Sign	No infringement	No infringement

In the case where the registered trademark owner has a reputation, they are likely to be afforded stronger enforcement rights. If a third party uses a trademark that is similar to a well-reputed brand, and uses that sign in any way that is likely to take advantage of or be detrimental to the trademark owner, they will have grounds to claim infringement.

For a successful claim of trademark infringement, the following remedies will most commonly be available:

- injunctions;
- damages or an account for profits;
- orders for the removal of infringing signs from infringing goods; and
- order for delivery up of infringing materials or articles.

U.S.

Under the U.S. Trademark Act (the Lanham Act), infringement occurs when one's trademark is used by another in commerce by another, without authorization, and the latter party's use of the mark is "likely to cause confusion or mistake or to deceive purchasers as to the source of origin" of the other's good or services.

Sections 32 (relating to infringement of registered marks) and 43 (relating to infringement of common law marks, trademark dilution, etc.) of the Lanham Act set forth the remedies that can be sought when a trademark is infringed or diluted, or when such acts may constitute unfair competition; these include injunctive relief, as well as monetary damages. In terms of monetary damages: a plaintiff may potentially recover: (a) the defendant's profits, (b) any damages sustained by the plaintiff (including lost sales), and (c) the costs of the action. In certain cases (*i.e.*, if the court finds the case egregious), a court may enter judgment for enhanced damages. And, in an "exceptional" case, the court may award reasonable attorney's fees to the prevailing party. Exceptional cases are generally found where the defendant's acts were willful.

D. Patents

Patent infringement occurs when a third party infringes any of the rights of the owner of a patent, as detailed in the *Types of IP - Patents - Do you need to register patents to obtain rights and what rights does a registration confer upon the owner?* section above. When developing an enforcement strategy, consider selective enforcement, as costs can escalate quickly and lawsuits invite countersuits. Also, outside of the U.S., there are usually limited patent damages available. Below are additional details in relation to courts that hear infringement cases and of the infringement remedies that are available in key jurisdictions.

Argentina

The law imposes civil and criminal penalties, such as injunctions, fines and imprisonment, on anyone who infringes a patent or a patentee's rights, as well as remedies to stop the infringement, such as seizure, inventory and attachment of the forged objects. A civil action called a "Cessation of Patent Use" may be filed by the patent owner or his or her licensee (if the patent owner chooses not to exercise his or her rights), in order to have the court order the defendant to cease the infringing activity and pay damages to the patent owner.

Australia

Actions for patent infringement generally take place in the Federal Court.

Until a patent has been granted, an interlocutory injunction to prevent infringement cannot be obtained. Once the patent has been granted, the patentee may seek injunctions and recover damages or an account of profits, including for infringements occurring between publication of the patent specification and grant.

A successful patentee may also be awarded additional damages if the court considers it appropriate in all the circumstances to do so, taking into account the flagrancy of the infringement, the need to deter similar infringements and the unjust benefits that the infringer has obtained.

Brazil

See the *Enforcing Your IP Rights - Copyrights* section for enforcement options.

China

For a design patent, the holder has the right to prevent any other person from making, selling, offering for sale or importing, without authorization, a product embodying the patented design for production or business purposes. The addition of "offering for sale" as an infringing act pursuant to the current Patent Law expands the protection for design patents. The 2001 Opinions define "offering for sale" as showing willingness to sell through advertisements, window displays or exhibits in trade fairs, etc.

Infringement is determined by reference to the drawings or photographs and the written brief descriptions included in the design patent application. The time limit for patentees to file infringement actions is two years from the date the patentee becomes aware, or should have become aware, of the infringing activity. Infringement action may be brought either through the People's Courts (by initiating civil actions) or through local Patent Management Bureaus (by filing administrative complaints).

France

Patent infringement occurs when the patented invention (as resulting primarily from the claims made out in the patent specification) has been reproduced in its essential elements.

See Copyright section for France for enforcement options.

Germany

See Copyright section for Germany for enforcement options.

Italy

Patent infringement is established when the patented invention (as resulting primarily from the claims) has been reproduced in its essential elements. Literal reproduction of all elements of the inventive idea is not strictly necessary in order to qualify as an infringement. On the other hand, there is no infringement if only one of the features of a claim is reproduced and this feature is not essential to the patent.

See the Copyright section for Italy for enforcement options.

Russia

See Copyright section for Russia regarding enforcement options. With respect to industrial designs, in addition to the remedies set forth in that section, such as damages, there exist specific remedies available to design patent holders, such as publication of a court decision on patent infringement.

UK

For a successful claim of patent infringement, the following remedies will be available:

- damages or an account for profits;
- delivery up or destruction; and
- injunction.

If a third party is concerned that their invention potentially infringes a granted patent, they are able to request an opinion from the UK IPO to the same effect.

U.S.

Remedies for patent infringement include injunctions and monetary damages. Monetary damages are typically calculated according to two models: lost profits and reasonable royalty. Lost profits typically exceed the amount recoverable under a reasonably royalty analysis, as they account for sales that would have been made by the patent holder but for the infringement.

E. Domain Names

Generally speaking, if a third party registered a domain name that is identical or confusingly similar to your company's trademark, the third party does not have a right or legitimate interest in the domain name and the domain name was registered and/or is being used in bad faith, the following actions are available:

- For domains in the gTLD space, such as .com, .net, .org or any of the new gTLDs that are rolling out:
    - filing a complaint under the Uniform Domain-Name Dispute-Resolution Policy (UDRP) – remedy limited to transfer or cancellation of infringing domain name;
    - for new gTLDs, filing a complaint under the Uniform Rapid Suspension System (URS) – remedy limited to suspension of infringing domain name;
    - claims under relevant national laws, *e.g.*, the Anticybersquatting Consumer Protection Act (ACPA) in the U.S. – remedies include a temporary restraining order, preliminary injunction, and statutory damages of between $1,000 and $1000,000 per domain registration.
- For domains in the ccTLDs space, such as .eu, .us, you must investigate the relevant procedures under each relevant ccTLD.

V. Licensing Your IP: General Considerations and Requirements

In this section, we will outline points to consider when your company is contemplating licensing its IP. We first discuss general considerations in licensing IP and then provide, on a country-by-country basis, rules relating to specific requirements for IP licenses in certain jurisdictions (such as duration of the license and recordal requirements) and highlights regarding issues specific to licensing particular IP assets. Note that paying and receiving royalties under IP licenses may have tax implications for the licensee and licensor, and tax advice should be sought by the parties early in the negotiations.

In **Appendices 1 and 2**, we also provide tips and checklists in relation to licensing of copyrights, trademarks and patents.

A. General Reasons to License

When your company licenses its IP, it is granting a third party the right to use your company's IP in order to generate revenue for your company. Licensing arrangements are commonly used to:

- generate additional revenue for your company;
- expand your company's product lines;
- expand your into new territories; and
- to collaborate with partners to exploit, improve and create new inventions, works or products.

Depending upon the nature of the IP asset, the obligations of the parties under the license, etc., royalties generally can range from as low as 2 percent to up to 30 percent.

B. Key Points to Consider When Licensing Your IP

As detailed below, before entering into a license it is critical that your company:

- performs the necessary due diligence on the prospective licensee;
- seriously assesses whether the licensee would be a good fit with your company;
- ensures its IP is registered in the territory covered by the license or any manufacturing or distribution agreements – otherwise, your company runs the risk that a pirate or even your own licensee, contract manufacturer or distributor could register the IP and, if the relationship turns sour, these entities could turn around and sue your company for infringement;
- ensures all elements legally required in the relevant jurisdiction(s) are present in the license agreement;
- determines what rights are to be given to the licensee in respect of the licensed products (*e.g.*, manufacturing, distribution, ability of licensee to sublicense to third parties, etc.)
- exercises caution in relation to the term of the license (*e.g.*, in a number of countries, a term must be specified; perpetual licenses are not legally enforceable);
- analyzes level of and responsibility for exercising/performing quality control;
- defines the specific geographic territory of the license;
- contemplates any restrictions regarding distribution channels;
- obtains advice in relation to whether the license must be recorded with relevant authorities in order to have legal effect;
- determines who will own rights in any improvements or adaptations of the IP; and
- considers the impact of any moral rights in relation to licenses of copyrighted works.

A careful weighing of the above issues will help guide your company in relation to drafting a comprehensive agreement and assessing key terms to negotiate with your prospective licensee.

Beware of "Accidental Franchises": Depending on the terms, a licence or distribution arrangement with extensive controls over the licensee or distributor's activities could amount to a franchise and additional regulatory requirements could apply. Among other things, these generally impose particular obligations on the "franchisor" and require extensive information to be disclosed to the "franchisee".

C. Licensing in the Fashion and Luxury Industry

In practice, licensing in the fashion and luxury space mostly relates to trademarks, including designer names as well as brands. Designs and/or patents rights are mainly licensed to third parties for manufacturing purposes only, whereas marketing and distribution is often reserved to the brand owner. However, while the designer or brand owner, in most cases, reserves to itself specific "core" categories of products, it commonly resorts to licensing as a powerful marketing tool to broaden the use of its trademarks in territories/business areas not currently served by the brand owner, such as fragrances and cosmetic products, jewelry and home furniture.

Generally speaking, the licensing approach must always be carefully planned in order to prevent future disputes, as well as to avoid any possible issues that might frustrate the final goal of maximizing the brand reputation. Licensing certainly has a number of benefit, such as spreading the risk and cost of development and distribution, achieving a quicker and wider market penetration, differentiating your company's products from those of competitors, earning initial or minimum license fees and/or ongoing royalty income, as well as tax benefits. On the other hand, licensing also presents some risks, notably the difficulty in recruiting, motivating and retaining qualified and competent licensees, and the administrative burden of monitoring and supporting the operations of a licensee's network – including quality control, auditing and infringements.

Accordingly, when entering into licensing agreements for any area of IP, there are number of general requirements that must be considered, including:

- the term of the license, taking into account the length of protection for each IP right;
- whether this is an exclusive or non-exclusive license and, if the license is exclusive, whether or not the licensor can also exploit the IP right;
- the amount of royalties to be paid to the designer/licensor;
- the right and circumstances for termination and renewal – it is imperative these requirements mirror the designer's/licensor's business plans and their long-term strategy;
- *intuitu personae*, *i.e.*, the license is essentially a personal services contract, such that a particular designer constitutes an essential term of the contract;
- quality control clauses: one of the main concerns in the fashion and luxury industry when approaching a licensee is how to control a licensee's use of the IP rights in particular trademarks, and to guarantee a high standard of quality of the goods. In this respect, quality control is crucial in the field of fashion or luxury goods, as the control in place will often directly affect the reputation and goodwill of a brand. If the license does not contain quality provisions, the licensor runs the risk of reducing the main function of IP rights: *i.e.*, to guarantee quality to the consumer. Moreover, in certain jurisdictions, such as the U.S., absence of quality control in a trademark license can be deemed to be an abandonment of rights in your company's trademark. Therefore, licensors must be constantly aware of how their IP rights are being used by licensees and be prepared to take action if any misuse has occurred. In this regard, it is essential that the licensor conducts preliminary due diligence on the licensee before entering into a license agreement, with the aim of verifying both the reputation of the licensee in the license-relevant market and the licensee's possession of the necessary skills, market experience and technical equipment. Furthermore, the license agreement must include the licensor's

right to periodically audit and inspect the licensee's premises during the effective term of the contract, to assess the use of the mark, the quality of goods and the manufacturing and/or distribution process. Such rights should be necessarily tied in with the financial penalties and/or termination rights.

When licensing out its brand, your company must appreciate that its entire reputation and goodwill may be damaged or destroyed by the act or omission of a single licensee. Accordingly, full attention must be given to what is going to be licensed (*e.g.*, which marks and the relevant products), where (*e.g.*, the specific territory of the license), on what basis (*e.g.*, exclusive or non-exclusive) and for how long (*e.g.*, term of the license, including renewal provisions). Moreover, appropriate provisions relating to how the trademark may and may not be used (*e.g.*, prohibitions against co-branding, repackaging/relabeling) and maintaining the image of the brand (*e.g.*, retailing conditions, quality of the retail stores, distribution network, supply chain, etc.) should be included in the license agreement.

Another issue that fashion and luxury brand owners commonly face when licensing out their brands to third parties is parallel import and counterfeiting. Therefore, the license agreement should always make clear that these actions are prohibited and include proper representations and warranties by the licensee in this respect. In addition to the licensee's obligations, the licensor's right to regularly audit and inspect the licensee's premises and warehouses, associated with termination rights, should always be provided in the license agreement. From a practical point of view, the use of means to certify and track goods are also instruments to prevent or limit these issues.

It is also possible to license **trade secrets**; however, great care must be taken, as your company is giving up exclusive control over its trade secret information. Although the license will have confidentiality provisions, etc., if such trade secret information is not properly monitored, marked and otherwise kept secret by the licensee, the trade secret may be lost.

Below are certain country-specific issues to consider in relation to IP licenses.

Argentina

Specific Requirements of a License

In principle, there is no requirement for granting a valid trademark license or any special considerations for a licensor or licensee in the luxury goods and fashion industry.

Recording the License

While recordal of the license agreement with the Trademark Office is not required, it is recommended, as it may afford certain tax advantages and is useful for evidentiary purposes in the event a cancellation action for lack of use is brought against the licensed trademark.

Thus, the recordal of the license agreement is an effective tool to use against third parties.

Australia

Specific Requirements of a License

In Australia, there are generally three levels of exclusivity in a license:

- an ***exclusive license*** gives the licensee the right to commercialise certain IP rights to the exclusion of all others, including the licensor;

- a ***non-exclusive license*** allows the licensee to commercialise the IP, although it does not prohibit the licensor or third parties from also exploiting the same IP; and
- a ***sole license*** permits both the licensor and licensee to commercialise the IP to the exclusion of all others.

With respect to trademarks, Australian law provides authorised users of registered trademarks (including licensees) with a limited set of statutory rights (*e.g.*, the right to commence proceedings for trademark infringement in some circumstances). These rights can be excluded by contract, and the licensor should consider whether it is appropriate to do so.

Exclusive licences and territorial and consumer restrictions, among others, may raise competition issues under Australian law. If the licensor and licensee are not competitors, these kinds of restrictions will be permissible, provided they do not have the purpose or likely effect of substantially lessening competition. Competition law advice should be obtained in order to be certain of this.

Duration of the License

In Australia, an IP license can generally be entered into for any term. However, under Australian law, a patent license can be terminated by either party on three months' notice at any time after the patent ceases to be in force.

Recording the License

IP licences are not required to be recorded; however, it may be in the licensee's interests to record the licence, as a recorded interest will limit the licensor's ability to deal with the IP and will put any proposed transferee of the IP on notice of the licensee's rights.

Brazil

Specific Requirements of a License

Except for the limitations below, the parties are usually free to determine the terms and conditions of the license regarding exclusivity, requirements regarding quality control, confidentiality, etc. With respect to copyright licenses, these are generally strictly interpreted in favor of the author.

Duration of the License

The license may be in force as long as the industrial property right subject to the license remains in force. Accordingly, for trademarks, which can be successively renewed for 10-year periods, the license can have an indefinite term.

Recording the License

Licenses relating to industrial property rights (*e.g.*, trademarks, patents and industrial designs) must be registered with the Brazilian PTO and the Central Bank of Brazil, so that they become effective vis-à-vis third parties, payments thereunder can be remitted abroad, and the Brazilian company can deduct such payments as business expenses for local corporate income tax purposes. Such registration is not required for the effectiveness and validity of the agreement in Brazil, but only for the effects described above.

In the case of copyright licenses, the registration with the Brazilian PTO and Central Bank is not required, but transfer pricing limitations apply to the remittance of royalties.

Royalty Payments

Brazilian laws and Ordinance No. 436/58 of the Ministry of Finance limit the tax deduction of payments for industrial property licenses and technical assistance. In the case of trademark licenses, the maximum amount is limited to 1 percent, calculated upon net sales of the products manufactured or the services rendered under the agreement. However, in the case of related companies (*i.e.*, in a parent/subsidiary relationship in which one party directly or indirectly controls at least 50 percent of the voting capital of the other party), the same percentage applies as a limit for remittance of royalties to the parent company abroad.

Canada

Specific Requirements of a License

A proper license will need to contain or evidence the following:

i. *Offer and acceptance*: The offeree must know that the offer was intended – that the offeror intended to enter into a contract. In the retail industry, an "offer to treat", whereby the offeror indicates a general intention to enter into a contract, is merely an indication of willingness to entertain offers and may not be seen as being a binding offer if accepted. Acceptance must be unconditional, clear and absolute to constitute acceptance at law. The practice of parties to an IP license providing for certain terms to be addressed at a later time is discouraged, as it can lead to confusion between a formed contract and merely an "agreement to agree".

ii. *Consideration*: Consideration can be small and need not be reasonable, but it must be real and must flow between parties. Royalties will be the typical medium of consideration, and may proportion payment into a minimum up-front component and a running of variable percentage of revenue earned by the licensee off sales of branded product.

iii. *Conditions*: Conditions in a license agreement are important when licensing in the luxury brand industry because they allow the brand to control its image, reputation and goodwill. Conditions may include a grant of exclusive territory, promises to promote or distribute a licensed product, limitations on use of IP, and the payment of royalties. Licensing of images will require conditions as to how the image will appear. The licensor of an image, luxury trademark, name or distinguishing guise will want to control how the image is produced or conveyed and the merchandise or entities in association with which it will be seen. Restrictions on marketing and distribution may be included to prevent sale of branded merchandise through discount, off-market or even mid-level retailers. Also important to maintaining reputation vis-à-vis product quality, licensors will often include conditions as to quality of materials, quality of manufacture, or location restrictions circumscribing where material may or may not be manufactured. Luxury brand owners may also seek to control the design and visual presentation of the licensee's products.

iv. *Representations and warranties*: These should be carefully drafted with a view to providing a basis for remedies should a representation prove to be false. Representations and warranties will provide an important contextual foundation for the license by serving to, among other things, confirm the status of IP rights, the status of the parties, freedom from restrictions, and affirmation and confirmation of knowledge vis-à-vis relevant matters and disclosures made with respect thereto.

v. *Customs notification*: For goods not manufactured in Canada, notification will be needed to facilitate customs clearance and avoid allegations of counterfeiting. Licenses will include representations and warranties requiring the licensor to provide customs notification as needed.

vi. *Validity of IP*: A licensee should acknowledge in the agreement that the IP being licensed is valid and that the licensor is the owner of all rights, title and interest in and to that IP. The licensee should also covenant not to contest the licensor's title to, or the validity of, the IP in any action or proceeding. In the case of trademarks, nor would it oppose the licensor's applications to register similar trademarks.

Recording the License

Copyright and trademark licenses do not need to be recorded with the Canadian Intellectual Property Office. Industrial design licenses must be recorded in the office of the Commissioner of Patents.

China

Specific Requirements of a License

A license must contain the following main terms:

- the rights being licensed;
- an indication whether the license is exclusive or non-exclusive;
- the geographic scope and term of the license;
- the amount and method of remuneration;
- liability for breach of contract; and
- other matters that the parties consider necessary to be agreed upon.

The Copyright Law provides that anyone wishing to use the work of another must (subject to certain exceptions) enter into a license contract with the copyright owner. A copyright owner may license all economic rights and receive remuneration for granting the license.

The Copyright Implementing Regulations require exclusive license agreements to be in writing, and provide for voluntary recordal of licenses. If the exclusive license is silent or unclear, the exclusive licensee is deemed to have the power to exercise his or rights to the exclusion of all other persons, including the copyright owner. Further, the regulations indicate that, unless otherwise agreed, exclusive licensees must obtain the copyright owner's consent to sublicense the copyright to third parties.

The Trademark Law requires a trademark registrant to enter into a written license contract when licensing registered trademarks to third parties.

It is noteworthy that compulsory licensing rules have long existed under China's Patent Law, but the Chinese government has yet to officially grant a compulsory license.

Duration of the License

The previous restriction limiting copyright licenses to 10 years has been removed under the Copyright Law.

Recording the License

Recordal of copyright licenses is voluntary.

Although recordal of trademark licenses with the Trademark Office is mandatory, there are currently no penalties for failure to record trademark licenses. The Trademark Law does provide, however, that a trademark license that has not been recorded may not be used against a *bona fide* third party.

Under the new Trademark Law, there is no need to submit a copy of the signed license contract to the Trademark Office when filing the recordal application.

With respect to design patents, the *Measures for Patent Licensing Contract Recordal* (the **Recordal Measures**), promulgated on 1 August 2011, have simplified and improved the procedure for the recordal of patent licensing contracts. On the other hand, the amount of content from patent licensing contracts required to be announced in the *Patent Gazette* has been increased, making it easier for parties to conduct patent due diligence.

Royalty Payments

The new foreign exchange regulations that came into effect on 1 September 2013 have removed the requirement for banks or financial institutions to review the Trademark License Recordal Certificate before approving the remittance abroad of foreign exchange by the licensee. In other words, trademark license recordal is no longer required for outbound remittance of license fees. For remittance of license fees amounting to or below $50,000, no documentation will be required for review by banks or financial institutions unless the source of funds is unclear or the remittance is suspicious. For remittance of license fees above $50,000, only a copy of the signed license agreement and the invoice are required to arrange for remittance, but the payer still needs to file a record of the transaction with the responsible tax authorities.

EU

Specific Requirements of a License

Community designs and Community trademarks may be licensed. From a legal point of view, there are no specific requirements applicable to license agreements, either with respect to the form or to its contents. Any license must comply with the general contract rules and public policy rules of the national law applicable to the contract.

Trademark License Agreements

Considerations of critical importance in relation to trademark license agreements include:

- obligation of exploitation of the trademark: indeed, lack of exploitation of a trademark may expose it to cancellation for non-use; in particular, in the case of exclusive license agreements. The use of the trademark by the licensee must be done in good faith, at the best of the licensee's capacities and within the bounds set out in the license agreement. In particular, the use by the licensee must not be susceptible to weaken the distinctive character of the trademark and turn it into a generic term. Even if this obligation is inherent to license agreements, it is highly advisable to expressly mention and frame it in the license contract.
- provisions aiming to protect the prestige, image and quality of the goods:

- manufacturing specifications, norms, audits, etc.;
- conditions of use of the trademark (co-branding, promotion, prohibition of repackaging and relabeling);
- respect of the brand image (retailing conditions, quality of the retail stores, distribution network, etc.).

These clauses are necessary in order to allow the licensor to sue its licensee for trademark infringement in the case of violation of these provisions, without facing the risk of the exhaustion of rights defense. Indeed, once a product is placed on the market by the trademark owner or with its consent, the latter cannot oppose the free movement of such product on the territory of the EU unless it has a legitimate reason to do so. In order to counter the exhaustion of rights defense, the trademark owner must prove that it had not consented to the placement on the market of such product, under the condition that certain specific provisions of the license (related to the duration, the territory, the form under which the trademark can be used, the products and services, and the quality of the concerned goods and services) have been violated.

In fact, the European Court of Justice (ECJ) has ruled that a violation of a provision related to the respect of the brand image and quality of the products, namely, the prohibition for the licensee to sell the products to discounters, resulted in a finding that the product had not been placed on the market with the IP right owner's authorization, and thus the trademark owner was allowed to sue its licensee for trademark infringement and the exhaustion of rights defense did not apply. This argument has been relied upon by many trademark owners in the fashion and luxury goods industry, more or less successfully.

Therefore, trademark owners must carefully draft the essential provisions of trademark licenses, and notably those related to the quality of the products (*e.g.*, brand image, distribution channels, repackaging and promotion) in order to control such products and have the ability to sue licensees for trademark infringement if a violation occurs.

Recording the License

Recording license agreements with OHIM is not required for the agreement to be valid and binding upon the parties. However, it is necessary for designs and trademark license agreements to be recorded with the OHIM in order to be enforceable against third parties in the context of litigation. In this respect, it is worth mentioning that it is not necessary to record the full license agreement (including confidential information such as the price of the license). A confirmatory deed containing the essential information (*e.g.*, name of the parties, IP right being licensed, term, territory) is sufficient.

France

Specific Requirements of a License

Under French law, any IP right may be subject to a license agreement.

From a legal point of view, there are no specific requirements applicable to license agreements, neither with respect to the form nor to its contents. Any license must comply with the general contract rules and public policy rules.

Copyright licenses:

Given the nature of French copyrights (comprising both assignable economic rights and inalienable moral rights), French law tends to consider that there is no difference between assignment and license of copyrights. Thus, copyrights license agreements must meet the requirements under the IPC with respect to copyrights assignment.

In this respect, the French IPC is very protective of authors' rights, and copyright assignments have to comply with very specific requirements, such as mentioning the form and scope of the assignment, *i.e.*, the duration and geographic area covered by the assignment, the intended purpose, and, above all, listing specifically each assigned right (reproduction rights/representation rights/amendment or adaptation rights when applicable), as well as the types of media concerned by the assignment (*e.g.*, print, film, internet, CD/DVD, etc.).

French judges interpret copyright assignments quite strictly and consider that if a right has not been expressly mentioned within the agreement, it remains vested in the author. Consequently, non-compliance with these provisions will affect the validity of the copyright assignment.

Moreover, it is very difficult to be granted an assignment on works that have not been created yet, as French law provides for a prohibition of general assignments made on future works.

While judges tend to consider that clauses providing for assignment as soon as the work actually materializes are valid, it is recommended that core products enter into a confirmatory deed of copyright assignment.

With respect to moral rights that are recognized in the author, the author is not entitled to assign or license them, as they are inalienable rights.

As a rule, only assignment agreements must be in writing. However, in practice, it is highly recommended that copyrights license agreements also list in writing all the rights that are to be licensed, following the abovementioned rules.

In addition, a copyright assignment has to provide for a financial compensation in order to be valid. In principle, this remuneration is proportional to the profits made from the exploitation of the work, except in some situations where a lump-sum remuneration is allowed (*e.g.*, where the basis for calculation cannot be determined or the contribution of the author is not one of the essential elements of the creation). To be on the safe side, the calculation of royalties in copyright license agreements should be in line with the rules applicable to copyrights assignment in this respect.

Trademark Licenses: See the EU section, as the same issues apply with respect to French trademark licenses.

Duration of the License

French law prohibits perpetual agreements. Thus, it is recommended to provide for a fixed duration of a reasonable time (usually no longer than 50 years), along with a renegotiation clause at the end of the term.

Recording the License

Recording of license agreements with the INPI is not a requirement for the agreement to be valid and binding upon the parties. However, for designs, trademarks and patents, it is necessary that license agreements are recorded with the INPI in order to be enforceable against third parties in the context of litigation. In this respect, it is worth mentioning that it is not necessary to record the full license agreement (including confidential information such as the price of the license). A confirmatory deed containing the essential information (name of the parties, IP right object of the license, term, territory) is sufficient.

Germany

Specific Requirements of a License

With respect to **copyright** licenses, the exploitation rights, including the right to reproduce, distribute, exhibit and make the work available to the public, may be assigned on an exclusive or a non-exclusive basis. The copyright as such may, however, not be transferred under German law, in view of the personal rights remaining with the author.

Trademarks as well as registered designs can freely be licensed.

Recording the License

A German trademark license cannot be recorded in the trademark registry.

Italy

Specific Requirements of a License

From a legal point of view, there are no specific requirements applicable to license agreements, neither with respect to the form nor its contents. The owner of a registered trademark may grant an exclusive or non-exclusive licence for it, with regards to all or part of the goods/services for which the trademark was registered. Such license may be granted for the whole Italian territory or for part of it. However, a statutory limitation does apply to non-exclusive licences. This limitation obliges the licensee to use the trademark only for the goods/services already identified by the relevant trademark in Italy.

This restriction stems from the policy of Italian law requiring trademark rights to be protected in such a way to prevent the use of the trademark in a manner that could deceive the public. The public must be guaranteed that a product bearing a certain trademark has substantially the same qualities as a similar product bearing that particular mark. As a result of this particular aspect of Italian trademark law, foreign owners of Italian trademarks that, in addition to not manufacturing their products in Italy, wish to grant non-exclusive licences to use the trademarks in such a country, should make sure that the Italian non-exclusive licensees are supplied with sufficient know-how, technical assistance and like information to ensure that its products will meet standards similar to those of products bearing the same trademark and manufactured by the licensor. Leaving aside the above requirement, the terms and conditions of a license agreement can be freely determined by the parties.

Duration of the License

There are no specific provisions under Italian law that require a license agreement to have a specific duration. Perpetual or indefinite licenses are not uncommon in Italy. However, the perpetual or indefinite duration of the license term may trigger the following two potential risks:

- that the license agreement be qualified as an assignment of the licensed rights: indeed, according to the prevailing Italian commentators' opinion, the *nomen iuris* (*i.e.*, the qualification given by the parties to the agreement) is not sufficient to classify a contract as a license. Such a classification should, rather, be made on the basis of the terms and conditions set forth in the relevant agreement. For example, on 3 June 2002, the Court of Milan identified certain elements, the combination of which qualifies an agreement as a license: (i) the restriction on the right of use; (ii) the limited duration of the right of use; (iii) the payment of a royalty instead of a lump sum; and (iv) the competitive advantage for the user. Although the decision specifically related to software licenses, such parameters can also be applied in respect of other IP license agreements; and

- that the indefinite/perpetual agreement be challenged as conflicting with the general Italian principle that obligations must always be temporary. The main consequence of this potential challenge is that it would be always possible for a party of the license agreement to unilaterally withdraw from the agreement at any time upon prior notice, even if such right is not expressly provided by the agreement.

Recording the License

Recording of license agreements with the IPTO is not a requirement for the agreement to be legally valid and binding upon the parties. Indeed, recording license agreements, especially non-exclusive license agreements, is quite unusual in practice. However, it may be advisable to record exclusive license agreements, in the event they expressly provide for the licensee's right to enforce the mark in the relevant territory, as this will provide notice to third parties of such a right.

Royalty Payments

Generally speaking, royalty payments are governed by the double taxation treaties and the relevant EU directives. It must be noted that in the case of licensing transactions between related parties, Italy generally applies the provisions under the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, dated July 2010. Tax and transfer pricing issues are discussed in more detail in Chapter 6.

Mexico

Specific Requirements of a License

The owner of the economic rights may freely transfer his or her economic rights or grant exclusive or non-exclusive licenses for use to any third party. Any grant of economic rights must be temporary, include a payment and be in writing, failing which such grant shall be null and void. However, it is important to note that moral rights are non-transferable and inalienable under Mexican law.

As for copyright licenses, the law sets forth that any license affording exclusive rights shall be expressly granted as such and will give the licensee, unless the parties agree otherwise, the right to exploit the work solely, along with the right to grant non-exclusive authorizations to third parties.

Duration of the License

A trademark license can be granted for a specific term or for the life of the registered licensed marks, as long as the licensee complies with all its obligations undertaken in the agreement and it does not breach the license.

Recording the License

All license or assignment agreements must be recorded in order to be binding against third parties.

Trademark Licenses

The registration of a trademark in Mexico grants its holder the right to use it solely and exclusively. However, foreign holders commonly do not use their trademarks directly in Mexico, but, rather, through Mexican subsidiaries or independent distributors. According to the IPL and its regulations, it is necessary to execute a license agreement between the trademark holder and its user, and record it with the Mexican Institute of Industrial Property (IMPI), in order for such a license to be valid against third parties.

Benefits of recording a license agreement with IMPI are:

- use of a trademark by a recorded licensee qualifies as use by the trademark holder and will provide a defense against third-party non-use cancellation claims; and
- a registered licensee has the right, unless the parties have agreed otherwise, to bring legal actions to protect the licensed mark, as if it were the owner. Nonetheless, should the licensor wish to prevent its Mexican licensee from enforcing any legal actions, it is possible to expressly limit said authority in the license agreement.

When a trademark is used by a recorded licensee, the sold goods or rendered services must be of the same quality as those manufactured or rendered by the trademark holder itself. Moreover, said products or the establishment where the services are rendered should indicate the name and domicile of the trademark holder along with the name and domicile of the licensee and the indication that use of the mark is performed “under license”.

The recording of a license agreement before IMPI may be cancelled only in the following cases:

- when both the trademark holder and the recorded licensee request it;
- due to the nullity, lapse or cancellation of the trademark registration, or when the registration of the licensed trademark application is not granted due to its rejection, abandonment or withdrawal; or
- by virtue of a judicial order.

Although recording a trademark license agreement has obvious benefits for trademark holders, it should be weighed against the risks, *i.e.*, the limitations in relation to the cancellation of a license agreement recordal. For this reason, although it is recommended a trademark license be recorded in order for the trademark owner to be able to prove use of the licensed marks in Mexico, it is also true that before doing so the trademark owner should assess whether it has other means to prove such use (*e.g.* that it issues invoices of sales directly to the Mexican customers, or to the Mexican distributor or licensee).

Royalty Payments

In addition to the legal consequences that may arise for failing to execute and record a trademark license agreement with IMPI, execution of a license agreement is important to give the trademark titleholder better control over the use of the trademarks, payment of royalties and advertising, etc.

If a license agreement establishes the payment of a royalty to the trademark holder and the licensor and licensee are related parties, the agreed consideration will need to comply with Mexican transfer pricing provisions. See Chapter 6 for details of these tax issues.

Russia

Specific Requirements of a License

The Russian Civil Code defines the general requirements for licensing of all types of IP rights. License agreements must be in writing. A licence may be granted for a defined IP asset, within the scope of expressly defined rights and means of use, with respect to a defined territory and for a defined term. If the territory is not defined, the license is deemed to be granted for the territory of the Russian Federation.

Under Russian law, the licensee has an obligation to provide the licensor with usage reports, unless the parties expressly state otherwise in the license agreement. The license agreement may contain other specific obligations of the licensee, such as an obligation to respect the licensor's requirements related to the quality of the goods produced under the license.

With respect to the licensing of fashion and luxury goods, it is important to note that the licensor should pay special attention to the Russian antimonopoly legislation when defining licensing requirements and limitations with respect to pricing policies, selectivity, geographical limits, etc., as such limitations and requirements may be seen by the Federal Antimonopoly Service as abuse of a dominant market position or as another antitrust law violation.

Duration of the License

If the duration of the license agreement is not defined, the agreement is considered to be concluded for five years.

Recording the License

To be valid and enforceable, license agreements on registered IP assets, such as trademarks and industrial designs, are subject to compulsory official registration with Rospatent. The absence of a registered license not only impedes the licensee's activity as the licensor's rightful representative but can result in early termination of the trademark protection as a result of a non-use action initiated by third parties, since the court handling the cancellation action may simply reject an unregistered license as invalid.

Royalty Payments

As of 1 October 2014, royalty-free licenses between companies are prohibited.

Spain

Specific Requirements of a License

IP licenses are subject to the general rules regarding licensing as contained in the relevant law.

Trademarks (including an application), designs (including a design application) and copyrights may be licensed for all or part of Spanish territory. These license agreements are not subject to any specific formalities; however, it is advisable that the contract regulate at least the following issues in order to avoid many conflicts in the future.

IP licenses governed by Spanish law may be exclusive or non-exclusive. Unless otherwise agreed, the exclusive license excludes even the licensor from using the licensed right. On the contrary, a non-exclusive license allows the licensor to grant other licenses and to use the licensed right for its own purposes. Thus, it is highly advisable for the parties to agree on the exclusive or non-exclusive nature of the license, because, unless otherwise agreed, it shall be understood that a license is non-exclusive.

Copyrights

The right to exploit the work may be licensed (transferred) and the license must be in writing. Such a license may be limited to the right or rights transferred, to the means of exploitation expressly provided for, and the term and territorial scope specified.

Duration: Failure to mention the term shall limit the license to five years, and failure to mention the territorial scope shall limit it to the country in which it is licensed.

Further, Spanish copyright law provides that if the parties do not mention the conditions governing the exploitation of the rights licensed, the license shall be limited to such exploitation as is necessarily deduced from the contract itself and is essential to the fulfilment of the purpose of the contract.

Spanish law also considers any global transfer of exploitation rights in all the works that the author (*e.g.*, the designer) may create in the future to be null and void. This means that a clause obliging a designer to transfer all the exploitation rights related to all the creations which he or she may create in the future may be considered null. Such a prohibition refers to all the creations in general without time limitation. Thus, as an example, it would not apply to broad licenses that are in force for a specified term, such as an employment contract or a services agreement.

Likewise, any stipulations whereby the author undertakes not to create any work in the future are deemed null and void. Again, this restriction shall apply to unlimited commitments. Non-competition agreements in respect of a specific industry or brand will not be affected by this prohibition.

With regard to the enforcement of rights, an exclusive license confers on the licensee the right to institute proceedings for infringements independently of the copyright holder.

Since copyrights belong to the author by virtue of the sole fact of creation; such that registration is not compulsory, the same applies to copyright licenses.

Trademarks

Spanish law provides that both an application and a trademark may be licensed for all or some of the goods and services the trademark is applied or registered for.

Unless the contracting parties decide otherwise, the holder of a license shall be entitled to use a trademark for the entire term of the registration, including renewals, throughout national territory and in relation to all goods or services for which the trademark is registered. Thus, it is advisable to expressly refer to the length of each of these aspects in the contract, in case the parties agree on different terms.

Notably, the luxury and fashion industry is particularly strong on-line. That means that a license limited to Spanish territory would not allow promotion and sales via the internet if such sales could be effective outside Spanish territory. In order to prevent that, the territorial scope of the license can specifically provide that it includes the internet.

Finally, with regard to the enforcement of rights, the holder of an exclusive license may, in its own name, exercise any legal action granted by the Spanish Trademark Act to the owner of a trademark in respect of third parties who infringe its rights, unless otherwise agreed. However, the holder of a non-exclusive license must request, via Notary, that the owner of the trademark commence the relevant legal action. Where the owner refuses to do so or does not bring the appropriate action within three months, the non-exclusive licensee may do so in its own name, attaching the request. Unfortunately, this remedy for the non-exclusive licensee is ineffective and inefficient in practice, due to the short seasons of the collections in the fashion industry. Therefore, whenever it is appropriate, it is advisable for licensees to be entitled by the licensor to bring legal actions in case of infringement.

Designs

Both an application and a registered design may be licensed for all or part of Spanish territory and for all or part of its possible applications.

Duration: Unless otherwise agreed, a licensee shall be entitled to use the design for the entire term of the registration, including renewals, throughout the territory and for all its applications. Therefore, it is advisable to expressly refer to the length of each of these aspects in the agreement if the parties agree on different terms. In this regard, the comments for trademark licenses above regarding territory and renewals are equally relevant in relation to design licenses.

With respect to enforcement rights, unless the license states otherwise, the licensee may bring proceedings for infringement of a design only if the rights holder consents thereto. However, in contrast to the provisions of Spanish trademark law, the holder of an exclusive license may unequivocally request that the owner or rights holder of the design bring the relevant legal action. Where the owner refuses to do so or does not bring the appropriate action within three months, the exclusive licensee may do so in its own name, attaching the request.

Recording the License

Although Spanish law states that a trademark license shall be binding on third parties acting in good faith only after recordal in the Trademark Registry, recent Spanish case law evidences flexibility with respect to this requirement and does not demand recordal in cases where a third party could have been aware of the existence of the license.

Spanish law for the legal protection of industrial designs provides that a design license shall be binding on third parties acting in good faith only after recordal in the Design Registry.

Royalty Payments

Although not required under Spanish law, license agreements usually provide for payment of a financial compensation, *e.g.*, a royalty, to the licensor. Note that Spanish copyright law expressly provides for an action to review inequitable remuneration. In the absence of agreement, this may be handled by the Spanish courts.

UK

Recording the License

While not an absolute requirement, recordal of a license at the UK IPO as soon as possible once execution has taken place is recommended. Failure to do so may result in the license being unenforceable vis-à-vis third parties without knowledge of the license and a loss of potential damages during the period prior to recordal.

U.S.

Specific Requirements of a License

Exclusive **copyright** licenses must be in writing.

Trademark licenses should always include quality control provisions: otherwise, a court may deem them to constitute "naked licensing". The effects of naked licensing include:

- the mark can be deemed abandoned;
- there could be a break in chain of continuous use (which may be problematic where trying to claim prior use over third party);
- the license could be found to be void; and
- the licensor may be estopped from challenging the licensee's uncontrolled use.

A common issue with licensing is the existence of parallel imports or gray market goods. These consist of products legitimately made by a foreign manufacturer in a foreign country under license, which are then imported into the U.S. and sold in competition with goods manufactured in the U.S. under the same trademark (either directly or via license). From a trademark perspective, generally if the goods are identical and both the foreign and domestic trademarks are owned and licensed by the same entity, the importation of competing gray market goods is permitted because there is no consumer confusion. However, if there are material differences between the U.S. and foreign gray market goods, the sale of the gray market goods in the U.S. can be enjoined. Copyright may also be a tool in preventing the importation of foreign goods if those goods share copyright-protected elements with a good owned by the U.S. party attempting to prevent importation.

Common obligations in **patent** licenses include pre-market entry milestones, producing a prototype, meeting regulatory requirements, post-market entry targets/sales targets, and that the licensee will not contest the validity of the licensed patent and the licensee will assign rights and grant the licensor a (non-exclusive or exclusive) license in improvements on the patented invention.

IP owners and exclusive licensees usually both have the right to sue third parties for infringement, but this can be limited pursuant to the terms of the license agreement.

Duration of the License

Terms of licenses should always be specified. If no term is specified, and irrespective of the termination provisions in the license, it is possible that either party may have the right to terminate the license at will. Generally speaking, a license can be granted for a term up to the term of the validity of the underlying IP.

Recording the License

Recordal of copyright, trademark and patent licenses with the U.S. Copyright Office or the USPTO, respectively, is not required.

VI. Conclusion

As set out in this chapter, a great deal of resources are involved in terms of creating, registering, enforcing and licensing your company's IP assets. It is important for every business to have procedures in place to identify IP assets, such as inventions and technology, designs, trademarks, protectable expressions or works, trade secrets, know-how and domain names. Moreover, from a risk management perspective, prior to using any IP, appropriate clearance searches and opinions on availability should be obtained from counsel. To protect your IP, registration is the first step. Registration of your IP rights is required in most countries, in order to enforce your rights against third parties. Moreover, from a licensing standpoint, licensees will generally want to know that the IP they are licensing has been registered.

We hope this chapter has provided you with helpful advice to assist your business in identifying what type of IP is relevant to your products; and on the process of registering the IP; how to enforce your IP rights when others try to copy designs or inventions, or ride on the coattails of the goodwill created by your company in its brand; and on how to expand your brand globally via licensing arrangements.

APPENDIX 1:
Copyright, Trademarks and Domain Names and Patent Playlists

Copyright Playlist

- **Where are you doing business?**
  - Which markets do you accept you are trading in?
  - Which markets do you not accept you are trading in?
  - Can you explain why if challenged?
- **Is ownership/right to use clear?**
  - Do your employment and commissioning contracts contain express assignments of present and future copyright?
  - Do your employment and commissioning contracts contain express waivers of moral rights?
  - Do your contracts take into account relevant local law restrictions on the ability to assign or waive copyright/moral rights?
  - Do you have records of who created the key copyright, and when and how it came to be owned by or licensed to you?
- **Can you enforce your rights?**
  - Have you considered whether to register any of your copyrights?
  - Do your licenses-in contain express rights to enforce?
  - Do your contracts include restrictions on uses that may be legally permissible conduct, e.g., decompilation, backup, etc.?
- **Do you have the third-party rights you need?**
  - Do you need to clear any music rights; in particular, music composition rights and performers' rights?
  - If you have customers that use third-party content, who is responsible for clearing any rights in content that they might use?
- **Do you stumble into any regulatory regimes?**
  - Are there any local content rules/quotas/levies for content services?
  - Are copyright levies payable on any hardware or services?
  - Are there particular content rating or child protection rules?
  - Are there restrictions on territorial licensing, or any other market partition, you need to consider?
- **Do you understand how the relevant safe harbour regimes work?**
  - Is there a safe harbor regime for intermediaries?
  - If so, is it a notice and take down regime or a notice and take down and counter notice regime?
  - Are there any legally prescribed timelines for action?
  - What level of filtering/monitoring is consistent with the safe harbor?
  - Is any proactive monitoring required?
- **If your business relies on U.S. law exceptions/case law, do your expansion markets allow the same conduct?**
  - Not many countries have a general fair use defence in their copyright law. This includes major expansion markets.
  - Many foreign courts have rejected novel arguments generated in U.S. case law, such as the Cablevision litigation.

  - Understanding the legal basis on which you can purport to justify your use is important if you are challenged.
- **Does your business model take into account the risk of copyright exhaustion?**
  - Is your business model vulnerable to parallel imports?
  - Should your licences be fixed term rather than perpetual?
  - Can you implement technical controls to prevent transfer?

Trademarks and Domain Names Playlist

1. **What are your trademarks?**
   a. Categorize into core, secondary, tertiary, etc. – *e.g.*, company name, names for products and services, badges, icons, etc.
   b. Assess whether marks are protectable, *e.g*., fanciful, arbitrary, suggestive, descriptive, generic.
2. **Where are you now and are you likely to:**
   a. expand in the next five to seven years;
   b. have agreements with suppliers/manufacturers; or
   c. have issues with counterfeiters/infringers.
3. **What is your budget for registering trademarks and domain names?**
   a. Consider whether to conduct trademark availability searches or just file.
   b. If your mark or corresponding domain name is not available, is it possible to get the owner to transfer it to your company?
   c. Prioritize which marks and domain names to register in which jurisdictions, gTLDs or ccTLDs.
4. **Filing and Registration Considerations and Strategies**
   a. Ensure trademark filings and domain name registrations are made in the name of the entity who will own your company's IP.
   b. Analyze filing strategies, *e.g*., file in U.S. first and then:
      i. file within six months in countries that are signatories to the Paris Convention (176 signatories as of 31 October 2014) and those foreign filings will be afforded the filing date of the US application, *or*
      ii. file for an IR through WIPO and then extend the IR into countries that are signatories to the Madrid Protocol (91 as of 31 October 2014).
   c. *Form of the mark*: Certain countries allow you to file in typed form, e.g., MICROSOFT, but in other countries, you need to register the form of the mark that you will actually use. So if you are using a logo, obtain advice as to whether you should register in typed form, for the logo or for both.
5. **Enforcing Your Trademarks: Infringements and Counterfeits**
   a. Prioritize key marks in key jurisdictions – don't go nuclear unless you have to.
   b. Take advantage of fora where enforcement mechanisms, such as on-line platform's terms of use, uniform domain-name dispute-resolution policy, etc., provide quick resolution and cost-efficient alternatives to litigation.
6. **Permitting/Licensing Others to Use Your Trademarks**
   a. Post trademark use policies and guidelines on your site and word them in a user-friendly fashion.
   b. For licenses, it's best to have these in writing and include provisions for and actually exercise quality control with respect to the licensee's use of the licensed mark.
   c. Make sure your trademarks are registered in any jurisdictions where you are granting licenses or permissions to use your marks.

Some jurisdictions require trademark licenses be recorded with the local trademark office or relevant agency. Ensure such recordals are made; otherwise, your rights may be jeopardized in those particular jurisdictions.

Patent Playlist

I. Patent Origination

1. File patents in the U.S. and abroad to maintain competitive advantage and to create value in the perception of investors.
2. Create strong invention assignment and confidentiality agreements. The company does not own patent rights to employee inventions absent such agreements.
3. Assignment agreements in non-U.S. countries must comply with local law requirements, which are often more onerous than the U.S.'s. Have such agreements reviewed by local counsel.
4. Establish rewards program for developers of patented inventions. Customary in the U.S., and in many foreign countries, additional compensation for inventions is mandatory.
5. Prioritize what inventions should receive patent treatment and what should (and can) just be preserved as a trade secret.
6. Do not sell any prototype of the invention, offer it for sale or disclose it to third parties, demonstrate at trade shows, or publish any material information about it in the U.S. or abroad, prior to filing the U.S. provisional application. Otherwise, the patent may be barred in the U.S. and foreign countries. Even confidential disclosures may cause a bar.
7. File provisional U.S. patent application as soon as possible. It only requires a general description of the invention. Note: in the U.S. and the rest of the world, first to file wins, even if not invented first.
8. Within one year after filing the U.S. provisional application, file U.S. utility application. Twenty patent year term from utility filing.
9. File non-U.S. patents: Patents are strictly geographic. Ownership of a U.S. patent does not give the owner the right to prevent the manufacture, use or sale of the product in any foreign country, with narrow exceptions, unless the U.S. patent owner has obtained counterpart national patent in the relevant foreign country.
10. File a PCT application within the same one-year period from U.S. provisional (usually at the same time as the utility application).
    - By filing within one year of the provisional application, the priority date relates back to the date the U.S. provisional was filed.
11. Decide what countries you should file in after the PCT application is filed. There is an additional 18-month period in which patent applications based on the PCT application may be filed in any PCT country, with priority relating back to the filing of the U.S. provisional application.
    - File applications in countries where: (i) you might market the product; (ii) you manufacture the product; (iii) competitors are based; or (iv) counterfeiters are likely to operate.
    - Use the 18 months to assess the market for the invention, the extent to which the cost and effort is worthwhile.
    - Assume fees of $7000-10,000 for each additional jurisdiction, and ongoing maintenance expenses.

12. While most commercially significant countries are PCT countries, some are not (*e.g.*, Taiwan, Argentina). Filings desired in non-PCT countries must be made within one year of the U.S. provisional application (or first filing).
13. Utilize new unitary European patent system (European Patent Convention), allowing for a single patent throughout Europe.
14. Determine if you have patentable subject matter in each country.

    U.S.: "any new or useful process, machine, …or improvement thereof"

    Europe: any invention must be susceptible to industrial application, be new and involve an inventive step as long as a computer program is not claimed "as such"

    Japan: any invention of "technical character"

    China: inventions possessing novelty, inventiveness and practical applicability.
15. Determine if any co-owners or third-party rights holders under applicable U.S. and foreign laws.

II. Enforcement of Patent

Consider selective enforcement of Patents in U.S. and other countries.

- Costs can escalate
- Lawsuits invite countersuits
- Limited patent damages available outside U.S.

III. Defensive Measures

- U.S.: *Inter Partes* review – administrative proceeding that allows a party to challenge the validity of a patent at the U.S. Patent Office, rather than before a jury
- Europe: Opposition proceeding – administrative proceeding that allows a party to challenge the validity of a patent at the European Patent Office

IV. Patent Licensing

16. Decide if you will license just your patents or also the technology covered by the patents.
17. Only license patents and patented technology in countries where you have national patents.
18. Comply with foreign competition laws, *e.g.*, certain license restrictions such as dividing customers or markets may be prohibited, especially in Europe.
19. Localize company forms when licensing out your patents or technology abroad, and translate license agreements where required by local law.
20. Carefully define rights granted to manufacturers, distributors and joint venture partners to avoid loss of rights or control and the effect of patent exhaustion.
21. Determine if your patents are deemed "essential," or otherwise subject to compulsory licensing regimes, thus requiring you to license them on FRAND (Fair, Reasonable, Non-discriminatory) or similar terms to third parties.
22. Record licenses with government authorities where required – in China, this is required in order to export royalty payments.

APPENDIX 2:
Trademark Licensing Checklist

a. Overview

- Is it really a license – licensing versus franchising versus distributorship arrangements?
- Indispensable elements
- What are the company's goals in terms of licensing?
- How much quality control is legally required?
- How much and what type of quality control is appropriate in the business context?
- What formalities must be considered?
- Comparison of requirements and considerations in relevant jurisdictions

b. Is it really a license -- licensing vs. franchising vs. distributorship arrangements?

Considerations

- Are you making available IP or selling products or services?
- Even if you are selling products or services, you may still need full protections available under a license
- Franchising involves a complicated disclosure regime and should be avoided if possible
- Exclusive distribution networks – an issue in all three arrangements
- Oral versus written/exclusive versus non-exclusive – implications

c. Common Elements

• Define grant of limited right and schedule of licensed marks • Ownership/Burden re: registration of Marks • Exclusive vs. nonexclusive • How IP can be used • Term • Territory • Royalty payments • Audit provisions • Approvals/inspections • Quality standards/Quality control • Best efforts/performance standards • Conditions for renewal	• Advertising • Protection of IP rights (who does it, who pays) • Sublicensing/assignment restrictions • Termination and consequences • Sell-off/reversion • Non-compete clause/restrictions on competing products • Insurance (vicarious liability) • Notification and handling of any infringement • Representations and warranties • Arbitration/mediation provisions • Governing law/jurisdiction

d. What are the company's goals in terms of licensing?

- Generate revenue
- Enhance consumer recognition by advertising and promotion
- Expand product/services lines
- Enhance company's image
- Co-branding option

e. How much quality control is legally required and how much and what type of quality control is appropriate in the business context?

- Key is "uniform quality" of goods/services
- Degree of control depends on types of goods/services being sold or offered **pharmaceutical products versus t-shirts
- Inspection – by whom? Licensor or independent third-party/licensing agent?
- Anti-trust considerations

f. What formalities must be considered?

- Must license be recorded with local trademark office?
- Are registered user agreements relevant?
- Is licensee's use enough to support use under local laws?

g. Comparison of requirements and considerations in relevant jurisdictions

- Requirements of license
- Liability of licensor/licensee
- Licensee estoppel
- "Related company" concept

Chapter 2:
Elements of Enforcement for Infringement in the Online/Offline Landscapes[1]

I. Introduction

After years of practice, brand owners in the luxury and fashion industry have become well versed in carrying out enforcement in the brick-and-mortar market. However, the prevalence of online counterfeiting is creating new obstacles. Jurisdictions with established intellectual property (IP) regimes, whether of the common law or civil law tradition, make available a range of civil, criminal and administrative enforcement options. Even jurisdictions with less-developed IP regimes have reasonably sophisticated offline enforcement options. The online landscape, on the other hand, presents a different story. As companies strive to innovate and create new online interactive platforms, infringers follow closely behind and constantly try to take advantage of these innovations. In the absence of a specific legal regime for online enforcement, counterfeiters are becoming increasingly elusive.

This chapter will be divided into two parts – the online landscape and the offline landscape. In each part, we will carry out a cross-jurisdictional examination of the current infringement trends, analyze the strategies that rights owners can adopt in protecting their brands, and discuss the obstacles faced in enforcement.

II. Enforcement in the Online Landscape

Infringers propagate counterfeit luxury goods on the internet with great efficiency and through a variety of means. Stand-alone third-party websites, e-commerce platforms, search engine and keyword advertizing and social media sites are amongst the most popular media. More recently, as rights owners and e-commerce platforms collaborate to impose tougher sanctions, there has been a noticeable rise in the sale of counterfeit goods on social media services in jurisdictions such as Canada and China. In other jurisdictions, like France, traditional online auction sites remain the most common source of infringement. Another interesting area of development is the rise of 3D printing and peer-to-peer (P2P) file sharing. While counterfeiters may take advantage of 3D printing technology to copy designs once they are created, P2P file sharing allows copies of design files to be spread rapidly online. Both trends are potentially problematic for the luxury and fashion industry. Further, many jurisdictions, including Japan, Australia and France, have noted that counterfeiters are becoming more sophisticated in their methods: e.g., by monitoring customs notices to identify brands that do not have customs recordal

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[1] Loke-Khoon Tan of the Hong Kong office is the principal author and editor of this chapter. Mr. Tan gratefully acknowledges the assistance of Bertha Ho of the Hong Kong office. The country-specific sections were prepared by Julia Dickenson, Jason Raeburn and Iona Silverman, London; Virginie Ulmann, Paris; Michael Fammler, Frankfurt; Cristina Duch, Anna Guix and Ariadna Suriol, Barcelona; Denis Khabarov, Moscow; Lorenzo de Martinis, Milan; Elisabeth White, Sydney; Andrew Sim, Beijing; Kenny Cheung, Hong Kong; Cheah Yew Kuin, Singapore; Kensaku Takase and Daisuke Tatsuno, Tokyo; Lisa Meyerhoff, Houston; Stephanie Vaccari, Essien Udokang and Alexandra Lewis, Toronto; David R. Rodriguez and Alvaro Correa-Ordoñez, Bogota; Sergio Legorreta-Gonzalez, Mexico City; and Bernard Malone, Buenos Aires.

in place, selling counterfeits at the same price as genuine products, and adopting domain names that avoid the use of core trademarks.

As a general rule, internet service providers (ISPs) that provide purely technical services, such as access to the internet, are not liable for infringing content. However, some jurisdictions require ISPs to take reasonable steps to disable access to infringing materials once they are notified of their existence. The European courts have granted injunctions against internet access providers in relation to both trademark and copyright infringement, although not without controversy. Similarly, website hosts are generally not liable for the contents they host, provided that they do not have actual knowledge of the illegal content, and remove such content once they are aware of it. While this "host defense" is largely the same across jurisdictions, the definition of "knowledge" does differ. Unsurprisingly, identifying the infringer remains the key challenge to enforcement in the online landscape. Despite the range of enforcement methods available, such as cease and desist letters, notice and take-downs and domain name dispute resolution procedures, it remains necessary to identify the infringer. As infringers hop between various platforms and switch between different hosts, enforcement becomes a perpetual game of whack-a-mole. Therefore, it is paramount for rights owners to adopt a comprehensive enforcement strategy and persist with execution of this strategy.

A. European Union

1. Online Infringement and Counterfeiting Trends across the European Union

a. Key Sources of Infringement

The key sources of online infringement across the European Union (EU) have been summarized in the relevant chapters of this work dedicated to the specific Member States of the EU. In summary, there are four main sources of online infringement: (i) online marketplaces/third-party websites; (ii) search engines and keyword advertizing platforms; (iii) social media platforms; and (iv) domain names (i.e., internet resource identifiers). Given the cross-border nature of the internet, websites are generally accessible simultaneously across a number of Member States within the EU and, therefore, the infringement of IP rights can give rise to either localised damage in one jurisdiction or, more likely, de-centralised damage across a number of Member States.

b. Evolving Nature of Online Counterfeiting and Infringement

There is a detectable evolution in the manner in which online infringers are operating and exploiting technology in order to produce and sell counterfeit goods. A recent example is the shift in focus from auction sites (which traditionally hosted a wide range of infringing items – and to an extent still do), to the proliferation of counterfeit activity on social media platforms, given the ease with which infringers can reach wide audiences and sell large quantities of counterfeit goods quickly.

Social media provides new ways in which infringers can advertize to and target potential consumers, and the use of private messaging and posts (sponsored or otherwise), as well as recommendations, facilitates this activity. These factors allow infringers to exploit these networks and conduct wholesale activity by offloading large volumes of counterfeit goods on a commercial scale.

Although the nature of online counterfeiting and infringement has evolved, so too have consumer habits and the enforcement strategies employed by rights holders. The various methods by which rights holders can identify, investigate and prevent online infringements are becoming more sophisticated. A high-level summary of some of these enforcement strategies is set out below.

2. Enforcement Strategies

a. Online Sweeps

An essential part of any online enforcement of IP rights is for rights holders to either conduct or engage third parties to conduct periodical online “sweeps” of the internet. This involves carrying out various different categories of searches (such as product specific or platform specific sweeps) to identify the online locations in which counterfeit goods are being offered for sale. This can be particularly helpful in obtaining a high-level view as to how prevalent and/or persistent infringing activity is in relation to a given product. The exact offerings of “sweep” providers vary but it is possible to conduct word searches as well as image-based searches. From a practical perspective, it is prudent to tailor any given search as much as possible and to identify the key features of well-known infringing products, in order to avoid searches retrieving a multitude of genuine listings.

b. Disabling Payment Services

Electronic payment processing is often the backbone of any online counterfeit operation, as the use of a well-known payment processing provider elicits a degree of trust from consumers. If an infringer’s account can be identified, a practical enforcement strategy that can be utilized (alongside other measures) is to file an infringement report with the relevant payment processing provider. The terms of use relating to any legitimate payment processing services will prohibit the use of their service in connection with illegal activity or for the infringement of third-party rights and will provide mechanisms by which infringing activity can be reported to them. These reports generally require a declaration to be made by the relevant rights holder that it has a good faith belief that a particular webpage or user is selling or making available goods or services that infringe its IP rights. Payment processing providers can then act on such requests to remove or disable the user in question, thereby cutting off their source of revenue. Of course, the issue with online infringement is that new accounts can be set up using different contact details and/or aliases, which increases the importance of maintaining an active monitoring strategy and considering court action, where appropriate.

c. Removing Advertizing Revenues

A further practical way to restrict counterfeit activity is to stem any advertizing revenues an infringer receives in connection with any traffic on either their own or third-party websites. Services such as Google AdWords have mechanisms by which the abuse of their services can be reported; counterfeit activity is often specifically prohibited, and a counterfeit goods complaint form can be filed to this effect, with a view to suspending the advertizing in question or disabling the relevant account.

d. Intermediaries

i. The Hosting Defense

The E-Commerce Directive (2000/31/EC) provides that Member States must ensure that information society service providers (i.e., those that provide services that consist of the transmission of information in a communication network that is provided by users, or the provision of access to a network) are not liable for infringements committed by their users, provided certain criteria are satisfied. Further information on this defense is set out in the UK chapter of this work. However, these limitations of liability do not act as an absolute bar preventing rights holders from obtaining blocking injunctions that require the termination or prevention of infringement, including the removal of information or disabling access to it.[2]

e. Domain Name Recovery

EURid is the domain name registry responsible for *.eu* country code top-level domains. It implements an alternative dispute resolution (ADR) procedure[3] for these domains that is similar in form and procedure to other domain name proceedings outlined under the country-specific chapters of this work. The ADR process is designed to be used where a domain name is identical or confusingly similar to a name in which a right is recognized or established by a national Member State and/or under Community law and where the domain name:

- has been registered by its holder without rights or a legitimate interest in the name; or
- where it has been registered or is being used in bad faith.

It should be noted that under the ADR procedure, non-EU persons can only request revocation of a disputed domain name and not its transfer. Once a decision has been made, it is then binding on the parties unless it is appealed in the court of mutual jurisdiction[4] within 30 days. The "mutual jurisdiction" of the parties is the jurisdiction to which the rights holder must submit as part of its complaint, and is usually the jurisdiction of the registrar in question but can be the country registered as the address on the infringer's original domain name registration.

f. Obstacles to Enforcement

In addition to the practical obstacles alluded to above in relation to identifying and preventing counterfeit activity (as well as those mentioned in the Member State-specific chapters of this work), one particular obstacle to effective civil enforcement online is the issue of jurisdiction. Given the nature of infringing activities carried out on the internet, damage can be caused in a number of Member States simultaneously. The issue of jurisdiction in relation to the infringement of copyright works online has been considered recently in the preliminary ruling of the European Court of Justice (ECJ) in C-441/2001 *Pez Hejduk v EnergieAgentur.MRW GmbH*. In summary, this case provides that copyright owners can sue in the Member State in which the relevant

[2] Recital 45 of Directive 2000/31/EC of the European Parliament and of the Council of 8 June 2000.
[3] Founded under Regulations (EC) No. 733/2002 of 22 April 2002 and 874/2004 of 28 April 2004 (as amended).
[4] Under article 22, par. 13 of Commission Regulation 874/2004 and B12 (a) of the ADR Rules.

damage was caused; however, that court would only have jurisdiction to rule on the damage sustained in that particular Member State. Alternatively, under the Brussels Regulation, the rights holder can bring action in the Member State in which the infringer is domiciled and seek pan-European relief, as discussed below.

B. United Kingdom

1. Online Infringement and Counterfeiting Trends in the United Kingdom

a. Key Sources of Infringement

Online infringement of IP rights relevant to the fashion and luxury goods industry ranges from the traditional, such as the sale of counterfeit goods on a third-party website, to the more technical, such as search engine keyword advertizing.

Key sources of online infringement include:

- Online marketplace/third-party websites: Auction sites (e.g., eBay) and online retailers (e.g., Amazon, Etsy) may unknowingly facilitate the sale of counterfeit and gray market (parallel imported) products.
- Search engines and keyword advertizing platforms (e.g., Google): Those seeking to promote fashion and luxury goods may seek to exploit the reputation of a well-known brand by purchasing keywords identical to the rights holder's trademark, such that a consumer search of the brand results in the provision of a link to the third party's website. Abuse of website keyword advertizing may constitute trademark infringement. It is an important issue faced by fashion and luxury goods brand owners, in an industry where online retail and marketing is key to developing brand awareness and sales.
- In *Cosmetic Warriors Ltd & Lush Ltd v Amazon.co.uk Ltd & Amazon EU SARL* [2014] EWHC 181 (Ch), Amazon purchased and used the keyword "lush" through Google AdWords, such that a Google search for "lush" resulted in the display of sponsored advertisements for the Amazon.co.uk site. In particular, the advertisements referenced Lush products even though no Lush products were available for sale on Amazon. The UK High Court found that there was infringement of Lush's trademark, as the advertisement would cause the average consumer to expect to find Lush products for sale on Amazon.
- Social media sites (e.g., Facebook, Twitter, blogs): Websites populated by user-generated content can facilitate the unauthorized use and sharing of copyright images and descriptions of fashion and luxury products. As copyright infringement, unlike trademark infringement, does not require that the unauthorized use be "in the course of trade or business", infringement can be committed as easily by individuals as by businesses.
- Domain names: Cybersquatting – bad faith registration of a third-party trademark (or variations thereof) to gain commercial advantage – can amount to passing off or trademark infringement, and can give rise to causes of action under dispute resolution mechanisms for domain names, such as by the World Intellectual Property Organization (WIPO) panel. Similarly, derogatory sites (e.g., [brand name]sucks.com) can give rise to causes of action where the registrant has acted in bad faith.

b. Evolving Nature of Online Counterfeiting and Infringement

The emerging concept of 3D printing will bring about new challenges in protecting against online counterfeiting and infringement.

Until recently, 3D printing (the printing of a three-dimensional article by depositing layers of powdered material onto a surface and hardening it with a laser) was a concept alien to the average consumer. Yet, this technology has advanced rapidly and 3D printers will soon be a mass-market product.

While fashion designers are beginning to embrace the possibilities that this technology offers in producing new collections, a major concern is that 3D printing will enable counterfeiters to copy designs as quickly as designers create them, both in the online and offline landscape.

Unauthorized P2P sharing of design files will rapidly result in infringing copies of fashion and luxury goods being printed. (This issue is dealt with in Part II, section 1.2 below.)

In the online context, P2P file sharing will likely raise issues for the fashion industry, as it has for the music and film industries. The digital design file for a work of fashion falls within computer programs, which are specifically included as literary works protected by UK copyright law (section 3 of the Copyright, Designs, and Patents Act 1988 (CDPA)). Therefore, the direct copying of a digital design file – for instance, by P2P file sharing – constitutes copyright infringement.

It is indicative that the infamous file-sharing website The Pirate Bay, which has been involved in a number of copyright claims, has already created a search category for 3D printer design files.

To combat this, the fashion and luxury goods industry could apply for a blocking injunction (see below) in conjunction with seeking to commercialize digital designs by selling files.

2. Enforcement Strategies

a. Laws Specific to Online Counterfeiting/ISP Liability

i. Blocking Injunctions

Section 97A of CDPA provides that the UK courts have the power to grant an injunction against a service provider, where that service provider has actual knowledge of another person using their service to infringe copyright. In order to obtain a blocking injunction, it is necessary to show that:

- the website has used the service provided to infringe copyright;
- the service provider had actual knowledge of such infringement; and
- an injunction is a proportionate remedy.

Blocking injunctions have been granted against ISPs in the film and music industries in a number of cases since 2010.

ii. The Hosting Defense

Article 14 of the E-Commerce Directive (2000/31/EC) provides that where an information society service is provided that consists of the storage of information provided by a recipient of the service (this can be an ISP or another online service provider, such as Google or Facebook), Member States shall ensure that the service provider is not liable for the information stored at the request of a recipient of the service, on condition that the provider:

- does not have actual knowledge of illegal activity or information and, as regards claims for damages, is not aware of facts or circumstances from which the illegal activity or information is apparent; or
- upon obtaining such knowledge or awareness, acts expeditiously to remove or to disable access to the information.

Most service providers benefit from this defense by enforcing a notice and take-down policy, so that as soon as they become aware of any actual or potentially infringing content, they take that content down.

In *L'Oreal v eBay* (Case C-324/09), the Court of Justice of the European Union (CJEU) held that eBay could not benefit from the hosting defense, since eBay's internal investigations had revealed unlawful activity but it had not taken the offending material down from its site.

b. Other Enforcement Strategies

A rights holder can commence domain name recovery proceedings if counterfeit goods are being sold from a website at a domain name that infringes a rights holder's trademark. To be successful, the rights holder must prove that: i) the domain name is identical or confusingly similar to the registered trademark; ii) that the registrant has no legitimate interest in the name; and iii) that it was registered in bad faith.

Nominet UK is the registry for *.uk* internet names. It offers a dispute resolution service for rights holders who seek to take down or transfer a domain name because it is identical or confusingly similar to their own and there is an element of bad faith in the use or registration of that name. To make a complaint to Nominet, the complainant must provide evidence of the abusive registration and demonstrate that:

- it has rights in a name that is similar or identical to the domain name; and
- the registration, in the hands of the respondent, is an abusive registration: i.e., takes unfair advantage of the registered trademark.

Following the respondent's submissions, Nominet will conduct informal mediation. If the matter is unresolved, Nominet will then appoint an expert to come to a written decision and this can be appealed. Following a decision, Nominet can transfer, cancel or suspend a domain name registration.

Rights holders often conduct online monitoring of infringing activity. This can be undertaken in-house, or it can be outsourced to a third party, to perform "sweeping services". Some websites have a specific rights' holder procedure for issuing take-down requests, whereas others merely require rights holders to notify them in writing of any alleged infringement. ISPs and other service providers have a duty to act expeditiously under the E-Commerce Directive; however, this is subject to their obligations under the Data Protection Act 1998 (see below).

Many online payment providers have a reporting mechanism to assist brand owners in combating the sale of counterfeit products online. If a brand owner reports an infringement to a payment provider, the payment provider can disable that infringer's use of its payment processing systems, so that the vendor cannot make online sales. However, this does not remove the counterfeit product from the website itself.

c. Standards for Enforcement

See Part II, section 1.2.

d. Obstacles to Enforcement

Some ISPs may demand that a rights holder obtains a court order to compel disclosure of the identity and contact details of an alleged infringer. The courts have made it clear that ISPs who refuse disclosure in compliance with the Data Protection Act 1998, or because they have doubts as to whether the rights holder is entitled to such disclosure, will not be penalized.

As a practical consideration, it may sometimes be difficult to locate the importer of gray market goods in order to initiate proceedings. Once located, rights holders are often faced with defendants being located outside the UK, which raises questions of jurisdiction.

As a general rule, the courts of the defendant's domicile have jurisdiction. In *Peter Pinckney v KDG Mediatech AG* (Case C-170/12), CJEU clarified that the courts in the place or places where the copyright infringement occurred or may occur also have jurisdiction.

In trademark infringement claims, this means that the claimant must show that a website targets consumers in a particular jurisdiction where the trademarks are registered. For example, if a website does not have the facility to sell products outside its jurisdiction, and it was not the website owner's intention that sales would be made outside that Member State, then local trademark law will apply (*1-800 Flowers Inc v Phonenames Ltd* [2000] FSR 697).

Another consideration specific to the UK is threats: proceedings for registered trademark or registered design infringement should only be commenced when the rights holder is confident that infringement can be proved; otherwise, the alleged infringer may bring an action for groundless threats. This could result in the alleged infringer being awarded an injunction and damages against the rights holder.

C. France

1. Online Infringement and Counterfeiting Trends

a. Key Sources of Infringement

Most of French case law with respect to online infringement relates to auction sites. So far, there have been almost no disputes resulting in legal proceedings that have involved e-commerce platforms, social networking services or instant messaging services.

i. Online Auction Sites

An online auction site's liability depends on its categorization. Indeed, pursuant to Directive 2000/31/ CE and the French Law on Confidence in the Network Economy No. 2004-575 of 21 June 2004, if the online auction site is considered a host, it can only be liable once it has been informed of the unlawful conduct and has not taken the necessary steps to stop this conduct; whereas if it is not considered a host, it can be liable for the infringement perpetrated by its users even prior to having this information.

French case law on the liability of auction sites was inconsistent for a long time, until the French Supreme Court settled the question in three decisions on 3 May 2012 (*Cour de cassation, 3 May, eBay/LVMH*), applying the ECJ ruling in the *L'Oreal/eBay* case (12 July 2011, C-324-09), according to which the service provider, in order to benefit from article 14 of Directive 2000/31, must be neutral while providing its services, and must not play an active role allowing it to have knowledge or control of the data stored. The operator plays such a role when it provides assistance that entails, in particular, optimizing the presentation of or promoting the offers for sale in question. In the three abovementioned decisions, the French Supreme Court denied eBay the benefit of article 14 on the grounds that eBay played an active role in its online marketplace, as it provided information and services to sellers in order to enable them to maximize their sales, and sent unsolicited emails to buyers and unsuccessful bidders to encourage them to purchase other items.

It is interesting to note that, before the abovementioned decisions, the Court of Appeal of Paris had applied the *L'Oréal v. eBay* ECJ case law and held eBay criminally liable for the first time, for the offense of receiving sales of trademark-infringing products, on the grounds that eBay received a commission on the sales of the infringing products when it could not have been unaware of the fraudulent activity of the two vendors, and did not implement measures to stop this fraudulent activity (Paris Court of Appeal, 23 January 2012, *eBay/Burberry*).

ii. E-commerce Platforms

There have been a few court decisions with respect to e-commerce platforms. For instance, the Court of Appeal of Paris held the platform Cdiscount.com liable for having Hello Kitty products on sale without the permission of the Hello Kitty trademark owner (Court of Appeal of Paris, 22 October 2010).

iii. Social Networking Services

Blogs

Under French law, blogs are comparable to websites. Therefore, blogs' authors are subject to the same obligations as any editor of a website: i.e., they are liable for the content published.

For instance, on 9 December 2010, the Court of Appeal of Riom found a blogger liable for having used a trademark to promote a cultural activity without the consent of the trademark's owner.

Social Networks

There are many different types of social networks, such as Facebook, Twitter, Bebo, Instagram, and Google+, that allow users to upload and share content with other users. These networks can contribute to IP rights infringement when users share materials protected by IP rights. To our knowledge, there is no court decision involving social networks based on IP rights infringement. This is probably due to the fact that these websites are not presently the most significant contributors to online infringement activity. Furthermore, they generally implement take-down procedures that discourage counterfeiting issues upstream of any legal proceedings (see below Part 1, 2b). Finally, it must be noted that Facebook has been recognized as a host by French courts (Tribunal of First Instance of Paris, 13 April 2010) and consequently can benefit from a favorable liability regime. This was recently confirmed by the Paris Court of Appeal (17 October 2014). It is likely that the other online social networks would benefit from the same liability regime.

Instant Messaging Services

To our knowledge, there is no French court decision involving instant messaging services regarding infringement.

b. Evolving Nature of Online Counterfeiting and Infringement

The increasing sophistication of online counterfeiters is one of the biggest issue for IP rights owners. One of the counterfeiters' techniques is the development of "*mushroom websites*", which are counterfeiting websites that have dozens of URLs belonging to the same structure. If the authorities block an address, 10 new URLs appear, converging to the infringing site.

Counterfeiters also developed many techniques to deceive consumers by making them believe that products purchased are original products. The first means to this end is "*cybersquatting*", i.e., registering a domain name corresponding to a trademark. They also create "*parking websites*", by registering a domain name corresponding to a trademark and displaying advertizing links on these so-called websites. Counterfeiters also employ "*typosquatting*", which is mainly based on typos made by the user when entering a web address in a browser. All these techniques increase significantly the traffic on counterfeiting websites.

2. Enforcement Strategies

a. Laws Specific to Online Counterfeiting/ISP Liability and General Liability for IP Infringement

i. Online Counterfeiting Laws

In 2009, France passed a much-debated anti-piracy law, High Authority of Diffusion of the Artworks and Protection of Rights on Internet (HADOPI), which established a three-strike system called the "graduated response" to punish persistent offenders who illegally downloaded, consulted or distributed works online.

The HADOPI law does not target the infringers but rather the holders of the internet accounts that have been used to illegally share material protected by copyright. The purpose of this system is to oblige the holders of internet access to secure it and to prevent any use of their access to download or share files illegally.

Under the three-strike policy, once illegal activity is noticed on a user's internet subscription, HADOPI sends the user a first notification to inform him or her that his or her conduct is illegal. If the user reiterates the infringement within six months of the first notification, a second email is sent to him or her, together with a registered letter requiring acknowledgment of receipt. If the infringer commits other infringement acts within the year following such notice, a new return notice is sent, informing the user that legal proceedings can be initiated against him or her.

HADOPI then has the possibility of informing the prosecutor of the case. If the user is found criminally liable, the court can impose a €1,500 fine and suspend his or her internet subscription.

Internet disconnection is no longer available as a penalty since a decree of 8 July 2013: online infringers may therefore only have a fine imposed on them. HADOPI continues to be severely criticized for its costs and lack of efficiency, despite an increase in its activity in recent months.

ii. Internet Intermediaries Liability

Internet intermediaries are subject to a specific system of responsibility that is provided for by the Law on Confidence in the Network Economy No. 2004-575 of 21 June 2004 (which transposed EU Directive 2000/31/CE into French law).

ISPs' Liability

The majority of the services that ISPs provide are technical, automatic and passive. These services do not involve active publishing or hosting of content. This is the reason why ISPs are under a specific liability regime. Indeed, under article L.32-3-3 of the French Code of Posts and Telecommunications, ISPs are not responsible for the content of websites to which they grant access unless they are at the origin of the transmission request at issue, or when they select the recipient of the message, or select or modify the content transmitted.

Hosts' Liability

Pursuant to article 6 of the Law on Confidence in the Network Economy, hosts shall be liable only if they were aware of the infringement and, after being put on notice, they did not promptly act to remove the infringing goods from their website.

In order to benefit from this specific liability regime, internet platforms rely on the "hosting defense" in most judicial cases. Under French and other European case law, hosting service provider status applies to the operator of an online marketplace where that operator has not played an active role allowing it to have knowledge or control of the data stored. According to the ECJ (Judgement C-324/09, *L'Oréal v. eBay*, 12 July 2011), the operator plays such a role even where it provides assistance, which entails, in particular, optimizing the presentation of the offers for sale or promoting them. French courts have recognized this hosting status in the case of many online platforms, such as Facebook, YouTube, Dailymotion and Google. Consequently, the rights holder can bring an action against the trade platform as soon as it plays an "active role" in the selling of the counterfeiting goods.

Content Providers' Liability

In the absence of a particular regime of responsibility, content providers, whether professional or non-professional, are responsible for the content they put on websites. General IP infringement provisions apply to them (see Part 2 below).

iii. General Liability for IP Infringement

In the case of online infringement, general liability for IP infringement rules applies to intermediaries that cannot benefit from the special liability regimes and to content providers (see Part 2 below).

b. Other Enforcement Strategies

i. Anti-counterfeiting Agreements

In order to efficiently fight counterfeiting on the internet, agreements between brands and e-commerce platforms have been signed.

For instance, on 11 October 2013, luxury goods brand owner LVMH reached an agreement with the Taobao.com website, owned by Alibaba Group (the leader in Chinese online shopping), to fight counterfeiting. Taobao committed to prevent the spread of counterfeit products by the adoption with vendors of proactive and preventive measures and the removal of suspicious offers. According to LVMH, these measures are the first steps Taobao has taken in direct cooperation with a brand. As 75 percent of counterfeit goods seized in Europe come from China, this agreement is a very important step in the fight against counterfeiting.

The e-commerce platform PriceMinister has been a signatory to the charter for fighting against counterfeiting applicable at the French level since 2009. Like other major internet platforms (eBay, Amazon and Allegro), PriceMinister is engaged in the fight against counterfeiting at a European level. Indeed, in 2011, PriceMinister signed the Memoranda of Understanding on the Sale of Counterfeiting Goods via the Internet, which encourages a proactive attitude. Under it, signing companies have to respect a monitoring obligation. They also have to report any illegal conduct or infringing goods, in order to allow their removal. Internet platforms commit to communicate identification data of the sellers of infringing goods. Given the above, companies should organize methodical monitoring of internet platforms and, when appropriate, issue take-down notices.

More recently, on 17 July 2014, LVMH and eBay announced that they had reached an agreement to put an end to their legal disputes before French courts and to cooperate to fight against the online sales of counterfeits. The exact content of this agreement has not been revealed.

ii. Take-down Notices

When online counterfeiting is identified, IP rights owners are entitled to issue a take-down notice to the website host.

French judges require unlawful content to be adequately notified to hosts by claimants. Under article 6-I.5 of the Law on Confidence in the Network Economy No. 2004-575 of 21 June 2004, hosts' awareness of litigious content is presumed if they receive a notification that contains a description of the facts, the precise location of the information and the reasons for the withdrawal request, including an indication of the legal provisions and factual motives. French courts are very strict on this issue and consider that liability of the host provider cannot be found if all the requirements of article 6-I.5 have not been met in the take-down notice

Once it has been informed of the unlawful content, the host has to take the necessary steps to stop the infringement. If it does not promptly react to remove the disputed content, it will be held liable.

However, the French Supreme Court ruled in three decisions of 12 July 2012 (No. 11-13666; No. 11-13669; No. 11-15165) that the host may not be held responsible if the unlawful content reappears on the website after the removal.

iii. Cease and Desist Notices

A typical cease and desist letter will give details of the IP rights infringed, explain why they are being infringed, and ask the alleged infringer to provide the rights owner with undertakings that it will stop the infringing activities, deliver up any infringing items still in its possession or control, give information about other entities involved in the supply chain, plus the manufacturer, and pay it an amount by way of settlement as compensation for its dealings with the infringing goods.

If the infringer does not answer positively to this notice, the IP rights owner can commence legal proceedings (please refer to Part 2 below).

In France, damages may be requested in cease and desist notices, but it should be noted that, in practice, infringers do not pay any damages at this early stage, unless a judicial action is initiated against them.

There is no equivalent in French law of the legislation against "*groundless threats of infringement*". Nevertheless, a cease and desist letter that is manifestly unfounded and abusive may trigger civil liability if the recipient can establish that he or she suffered prejudice because of this letter and that the letter was not justified by a legitimate interest (such as protecting IP rights). In practice, findings of such liability are very rare.

iv. Domain Name Dispute Resolution Procedures

When domain names infringe IP rights, the owner of those IP rights can employ ADR.

Uniform Domain Name Dispute Resolution Policy

The Uniform Domain Name Dispute Resolution Policy (UDRP) proceedings applies to the domain names extensions .com, .net and .org, as well as to a number of more recently introduced generic top-level domain names (gTLDs), such as .biz, .info, .jobs, .mobi, .pro, .travel and .tel, and can be conducted either before WIPO, the Czech Arbitration Court (CAC), National Arbitration Forum (NAF), the Asian Domain Name Dispute Resolution Centre (ADNDRC) or Arab Center for Dispute Resolution (ACDR).

UDRP proceedings provide an efficient remedy against bad faith/abusive registration of domain names that violate trademark rights. Indeed, cancellation or transfer of the disputed domain name can be imposed.

As the UDRP procedure is administrative, it can be used without prejudice to judicial action before competent courts.

Regarding the new gTLDs, the Uniform Rapid Suspension System (URS) can be used in order to obtain the suspension of a disputed domain name before the NAF or ADNDRC.

ADR

As regards <.eu> domain names, the ADR procedure is that set forth by EU Regulations No. 733/2002 and No. 874/2004. It is a relatively straightforward and cost-effective tool designed for cases of speculative and abusive registrations. This procedure can be used to obtain either the revocation of the domain name or, if the complainant is established within the EU, the transfer of the domain name.

Regarding the procedural aspects of the ADR procedure, it is quite similar to the URDP procedure. The designated arbitrator in ADR procedures is a panel from CAC. The complaint must be filed on the www.adr.eu platform. The procedure will be conducted in the language of the registration of the disputed domain name, unless otherwise agreed by the parties or otherwise decided by the panel. Upon filing of the complaint, it usually takes three to four months before a decision is published. During this time, all transactions (in particular, transfer) involving the domain name are suspended. The decision issued by CAC is not appealable and is enforceable unless the parties initiate court action within 30 days after notification of the decision.

SYRELI

As regards <.fr> and <.re> domain names, the applicable ADR procedure is *SYstème de REsolution de LItiges* (SYRELI), managed by the *Association Française pour le Nommage Internet en Coopération* (AFNIC) (France's top-level domain manager).

As AFNIC is also the registry for <.fr>, it can rule against the registration or the renewal of any domain name in <.fr> and is also in charge of the dispute resolution system. Thus, it has a unique role as both a decision-maker and a judge.

The aim of SYRELI is a quick, inexpensive, amicable resolution of conflicts in the field of domain names, when a third party having an interest, notably because he or she owns a trademark, considers that a domain name identical or similar to that trademark was registered without any legitimate interest by someone acting in bad faith.

The petition with all supporting documentation must be sent electronically to AFNIC. The SYRELI process begins only after an examiner in charge of administrative management of the request has duly verified that the submitted file is complete and ready to be examined. This is electronically notified to the registrant of the disputed domain name, who has a 21-day period in which to answer. The procedure is then examined by a committee of two permanent experts (and two substitutes) from AFNIC, who have been appointed by the General Manager of the AFNIC, who is himself or herself a member. The decision must be made by a majority of the members, within 21 days following the expiration of the period granted to the registrant to respond to the rapporteur's notification. Reasons are given for the decision, which is notified to the parties by electronic means or in writing, and forwarded to the registration office.

Depending on the petition filed with AFNIC, the panel may decide to transfer or delete the domain name or reject the claim. The final decision is enforceable 15 days after the notification of the decision to both parties. However, the enforcement of the decision may be suspended if, during this period, one of the parties provides the panel with evidence that judicial proceedings have been initiated in relation to the domain name in dispute.

The official fee for this procedure is €250. This fee is non-refundable and cannot be claimed against the losing party. In addition, no damages may be claimed through this procedure.

A judicial or extrajudicial procedure (arbitration or mediation) cannot be initiated in parallel. In such a case, the claimant's request is either rejected by the examiner in the examination phase of the request, or, if the committee's decision has already been issued, this decision will be suspended.

Pursuant to article L 45.6 of the French Code of Posts and Telecommunications, the procedure will not last more than two months, but it should be noted that the procedure is conducted in French. Consequently, a certified translation by a sworn translator must be drawn up by the parties for all submitted documents that are not in French. Moreover, except in a case of force majeure, no deadline extension will be granted.

SYRELI applies to domain names reserved or renewed after 1 July 2011. For domain names reserved or renewed up until 1 July 2011, only the judicial route, arbitration or mediation are available if the claimant does not want to wait until the next renewal.

As a consequence, the ADR procedure for .fr domain names previously managed by WIPO is now managed by AFNIC. Although the rules governing this procedure are globally the same as the previous ones, it should be noted that SYRELI decisions will not be rendered by independent panelists from a list established by WIPO, but by AFNIC employees.

c. Standards for Infringement

Standards for online infringements of IP rights are identical to those of offline infringements (see Part 2 below).

However, the international character of the internet has led the French courts to adopt jurisdiction criteria, which now seem established and vary depending on the IP rights that are infringed.

i. Design, Trademark and Patent Infringement

As regards design, trademark and patent infringement on the internet, courts apply the targeted consumers criteria applied by the French Supreme Court since the *Hugo Boss* case (Commercial Division of the *Cour de cassation*, 11 January 2005). This criteria has been confirmed by the ECJ in the *L'Oréal v. eBay* case (ECJ, 12 July 2011).

According to this criteria, the mere fact that a website is accessible from the territory covered by the trademark is not a sufficient basis for considering that the offers for sale are targeted at consumers in that territory.

National courts must assess on a case-by-case basis whether there are any relevant factors on the basis of which it may be concluded that an offer for sale, displayed on an online marketplace accessible from the territory covered by the trademark, is targeted at consumers in that territory. Relevant factors include details of the geographic areas to which the seller is willing to dispatch the product, language of the website and extension of the website.

ii. Copyright

In online copyright infringement matters, French courts apply the accessible website criteria.

The relevant criteria is not whether the activity of the website is "directed to" the Member State of the seized court but, rather, whether online copies are accessible in that Member State.

As a consequence, French courts have jurisdiction to determine liability and damage caused on French territory by online infringement of works protected by copyright in France.

This criteria has been applied and confirmed by the ECJ and the French Supreme Court in the *Pinckney* case (ECJ, *Pinckney/KDG Mediatech AG*, 3 October 2013; *Cour de cassation*, 22 January 2014).

d. Obstacles to Enforcement

Even if intermediaries have an obligation to retain data to identify users of their services (article 6.II.3 of the Law on Confidence in the Network Economy), there are still difficulties in identifying infringers. Indeed, rights holders and public authorities are confronted with almost absolute anonymity or false identities of counterfeiters. In addition, online counterfeiters may, because of their high mobility, prefer to live in countries where the protection of IP rights is less organized: their location and, therefore, their prosecution are all the more complicated. Finally, orders that are anonymous and mailed in small amounts are difficult to control.

Furthermore, there is the problem of effectiveness of judicial decisions. Indeed, pursuant to article L. 336-2 of the French IP Code, judges may order an ISP to block a website. However, it is still possible for counterfeiters to circumvent the measures ordered by providing a similar service using an address or domain name that is not locked, through a "*mirror site*". Rights owners are very aware of this issue and in *Allostreaming* (Court of First Instance of Paris, 28 November 2013), they asked the court to allow them to apply the blocking measure to future mirror sites. The court refused to grant this request. The risk of development of "*mirror sites*" is therefore still very high and the effectiveness of judicial decisions rather hypothetical.

Finally, when dealing with online infringement, one must keep in mind that an overly aggressive approach can be counterproductive, since it can result in negative buzz on social networks.

D. Germany

1. Online Infringement and Counterfeiting trends in Germany

a. Key Sources of Infringement

Key sources of online infringement include:

- Online marketplace/third-party websites: Auction sites (e.g., eBay) and online retailers (e.g., Amazon and Etsy) may unknowingly facilitate the sale of counterfeit and gray market (parallel imported) products.
- Search engines and keyword advertizing platforms (e.g., Google): Those seeking to promote fashion and luxury goods may seek to exploit the reputation of a well-known brand by purchasing keywords identical to the rights holder's trademark, such that a consumer search of the brand results in the provision of a link to the third party's website. Abuse of website keyword advertizing may constitute trademark infringement. This is an important issue for fashion and luxury goods brand owners, as online retail and marketing are key to developing brand awareness and sales in these industries.
- Social media sites (e.g., Facebook, Twitter, blogs): Websites populated by user-generated content can facilitate the unauthorized use and sharing of copyright images and descriptions of fashion and luxury products. As copyright infringement, unlike trademark infringement, does not require that the unauthorized use be "in the course of trade or business", infringement can be committed as easily by individuals as by businesses. However, a privilege exists for private copies of protected works.

- Domain names: Cybersquatting – bad faith registration of a third-party trademark (or variations thereof) to gain commercial advantage – can be in violation of the German Unfair Competition Act or the German Trademark Act. Germany does, however, not have any dispute resolution mechanisms for domain names similar to those of the WIPO panel. Consequently, domain names have to be recovered in civil proceedings.

b. Evolving Nature of Online Counterfeiting and Infringement

i. 3D Printers

The emerging concept of 3D printing will bring about new challenges in fighting online counterfeiting and infringement.

Until recently, 3D printing (the printing of a three-dimensional article by depositing layers of powdered material onto a surface and hardening it with a laser) was a concept that was alien to the average consumer. Yet, this technology has advanced rapidly and 3D printers will soon be a mass-market product.

While fashion designers are beginning to embrace the possibilities that this technology offers in producing new collections, a major concern is that 3D printing will enable counterfeiters to copy designs as quickly as designers create them, both in the online and offline landscape.

Unauthorized P2P sharing of design files will rapidly result in infringing copies of fashion and luxury goods being printed (see Part II, 1.2, e for additional information).

In the online context, P2P file sharing is likely to raise issues for the fashion industry, as it has for the music and film industries. The digital design file for a work of fashion falls within computer programs, which are specifically included as literary works protected by German copyright law (sections 69a-69g of the German Copyright Act (*UrhG*)). Therefore, the direct copying of a digital design file, e.g., by P2P file sharing, constitutes copyright infringement.

It is indicative that the infamous file-sharing website The Pirate Bay, which has been involved in a number of copyright claims, has already created a search category for 3D printer design files.

To combat this, the fashion and luxury goods industry could apply for a preliminary cease and desist injunction (see below) in conjunction with seeking to commercialize digital designs by selling files.

ii. Short-lived Web Shops (Fake Shops)

Another emerging concept is that of fake online shops. These are entire online retail stores, often tailored to a single product branch (e.g., clothing, notebook accessories) or a specific brand (e.g., Nike), where customers can browse goods and eventually order them. Such stores offer cheaper-than-normal prices and only accept cash in advance. The purchased goods are either never delivered or are of poor quality. After several days or weeks, the shop is taken offline and simply reopened under a different domain name with a slightly altered design and products.

Not only are such shops a powerful tool for fraud, especially when combined with keyword advertizing, they infringe IP rights such as trademarks, designs and, in cases when products of poor quality are delivered, patents, utility patterns and the principles of fair competition.

Owing to the short-lived nature of these shops and the high probability of operations being conducted from outside the EU, it is likely to be difficult to successfully file a lawsuit, or even obtain a preliminary injunction, against the infringers themselves.

2. Enforcement Strategies

a. Laws Specific to Online Counterfeiting/ISP Liability

i. Blocking Injunctions

In the recent decision *UPC Telekabel Wien GmbH v Constantin Film Verleih GmbH, Wega Filmproduktionsgesellschaft mbH* (Case C-314/12), the ECJ held that blocking injunctions against ISPs are not precluded by fundamental rights recognized by EU law. Even though the possibility of blocking injunctions must now be accepted, German courts, in contrast to courts in many other European countries, are very restrictive when it comes to such injunctions. This is mainly because German law does not provide for a clear legal claim against ISPs; instead, claims have to be developed from previous judicial decisions. Generally, German courts accept blocking injunctions if three prerequisites are met: (i) the ISP has to know about the infringement; (ii) the blocking has to be technologically possible; and (iii) the blocking has to be (economically) reasonable.

The Higher Regional Court of Cologne recently denied a blocking injunction, with the main focus of the decision being the reasonableness of the blocking, which is subject to a narrow interpretation. The court addressed problems that could arise in light of the fundamental right to secrecy of telecommunications but found that not all possible blocking methods infringed said right. However, the court ultimately found that none of the possible blocking mechanisms were reasonable, since some of them were easily bypassed by internet users as well as infringers, and others had a high risk of blocking legal content. Additionally, the court found the costs for implementing effective blocking mechanisms were unreasonable compared with the economic loss incurred by the infringement.

With all the controversy even in the German legal literature surrounding blocking injunctions, they cannot be considered a viable option for IP rights enforcement at this time.

ii. The Hosting Defense

Article 14 of the E-Commerce Directive (2000/31/EC) provides that where an information society service is provided that consists of the storage of information provided by a recipient of the service (this can be an ISP or another online service provider, such as Google or Facebook), Member States shall ensure that the service provider is not liable for the information stored at the request of a recipient of the service, on condition that:

- the provider does not have actual knowledge of illegal activity or information and, as regards claims for damages, is not aware of facts or circumstances from which the illegal activity or information is apparent; or
- the provider, upon obtaining such knowledge or awareness, acts expeditiously to remove or to disable access to the information.

Most service providers benefit from this defense by enforcing a notice and take-down policy, so that as soon as they become aware of any actual or potentially infringing content, they take it down.

The same privilege can be found in section 8 of the German Teleservices Act.

In *L'Oreal v. eBay* (Case C-324/09), the CJEU held that eBay could not benefit from the hosting defense, since eBay's internal investigations had revealed unlawful activity but it had not taken the offending material down from its site.

Similarly, the Federal Court of Justice of Germany stipulates extensive internal investigation obligations specifically for host providers.

b. Other Enforcement Strategies

The manager of the .de country-code top-level domain for Germany is DENIC Verwaltungs- und Betriebsgesellschaft eG (DENIC). It does not employ a uniform domain name dispute resolution policy, as established by the Internet Corporation for Assigned Names and Numbers (ICANN). In 2001, the Federal Court of Germany decided that DENIC cannot be held liable if domain names infringe a rights holder's rights unless the infringement is obvious, which is almost impossible to prove.

Private claims for disclosure against ISPs require a preceding court order. The court has to examine whether the infringement is obvious and that disclosure can only be achieved using ISP traffic data. This, however, is not the case with prosecuting authorities that can request full cooperation from ISPs.

Rights holders often conduct online monitoring for infringing activity. This can be undertaken in-house, or it can be outsourced to a third party, to perform "sweeping services". Some websites have a specific rights' holder procedure for issuing take-down requests, whereas others merely require rights holders to notify them in writing of any alleged infringement. ISPs and other service providers have a duty to act expeditiously under the E-Commerce Directive (2000/31/EC).

Many online payment providers have a reporting mechanism to assist brand owners in combating the sale of counterfeit products online. If a brand owner reports an infringement to a payment provider, the payment provider can disable that infringer's use of its payment processing systems, so that the vendor cannot make online sales. However, this does not remove the counterfeit product from the website itself.

c. Standards for Enforcement

See Part II, section 1.2.

d. Obstacles to Enforcement

As a practical consideration, it may sometimes be difficult to locate the importer of gray market goods in order to initiate proceedings. Once they are located, rights holders are often faced with defendants being located outside Germany, which raises questions of jurisdiction.

Under the general rule of Regulation (EC) No 44/2001, the courts of the defendant's domicile have jurisdiction. In *Peter Pinckney v KDG Mediatech AG* (Case C-170/12), the CJEU clarified that the courts in the place or places where the copyright infringement occurred or may occur also have jurisdiction.

According to Regulation (EC) No 864/2007, the law applicable to an infringement of IP is that of the country for which protection is claimed.

In trademark infringement claims, the claimant must furthermore show that a website targets consumers in a particular jurisdiction where the trademarks are registered. In *Hotel Maritime* (BGH I ZR 163/02, 13 October 2004) and OSCAR (BGH I ZR 75/10, 8 March 2012), the Federal Court of Justice held that the online use of a trademark only constitutes an infringement if the use has a commercial effect on the German market. This has to be judged based on an assessment of all factors for and against it. For example, there is a strong indicator of a commercial effect if the website is directed toward the German market: i.e., if it provides a German language selection or an option for shipping to Germany.

E. Italy

1. Online Infringement and Counterfeiting Trends

i. General Trends

Counterfeiting is a phenomenon of primary importance in Italy, as it negatively impacts to a great extent the fashion and luxury sectors, which are critical to the Italian economy. In recent research by the Ministry for Economic Development, together with Censis, an important Italian research institute[5], it is stated that counterfeiting generates a total turnover of €6.5 billion. The clothing and related accessories fields are the most affected sectors (34 percent of turnover).

While counterfeiting of clothing products and accessories has always been a highly significant phenomenon in Italy, counterfeiting of design and perfume products has lately reached major proportions, and it appears to be steadily growing.

Despite the significant digital divide still affecting the Italian territory, e-commerce is strongly growing as a sales channel, and the online sale of counterfeits is growing with it. In this regard, the Italian Competition Authority's research underlines how counterfeiting negatively affects the development of e-commerce in Italy.

Important data on online counterfeiting has been gathered in recent research funded by the Ministry for Economic Development, with particular reference to the subsectors of glasses and shoes[6]. Among other things, the analysis highlights that the average consumer has an 18 percent probability of coming across counterfeit products while searching for genuine products through major search engines. This rate increases to 28 percent for luxury brands. The most affected search engine is the Chinese Baidu. The techniques used by counterfeiters to obtain such advantageous positioning in search results vary: in some cases, the word corresponding to the brand is repeated several times in the web page; in others, they focus on creating fake pages that resemble the real ones as much as possible.

[5] http://www.uibm.gov.it/attachments/article/2007743/Rapporto%20contraffazione%202014_Sintesi%20.pdf
[6] http://www.uibm.gov.it/attachments/indagine_contraffazione_web_convey.pdf

a. Key Sources of Infringement

According to the available data, regular e-commerce platforms and auction sites contain about 80 percent of the web pages hosting counterfeit products bearing Italian marks or foreign marks but that are also manufactured in Italy. The most affected platform is the Chinese Taobao, which is reported to host an amount of counterfeits more than four times as large as that hosted by eBay and Amazon together.[7]

As to server localization, more than half of the pages hosting the sale of counterfeits are located in the US, while the remainder is distributed between Europe and China.

As regards search engines, web pages hosting the sale of counterfeits usually manage to achieve a good positioning in search engine results, including by resorting to the search engine optimization (SEO) techniques mentioned above. Search engines then become a powerful means for counterfeiters to have the web pages hosting the sale of their products reached by consumers. Baidu stands out as the search engine most likely to direct Italian users to pages hosting the sale of counterfeits.

We are not aware of official data describing particular counterfeiting practices carried out through other kinds of internet platforms, such as social networking sites or instant messaging services, with specific regard to the Italian market. However, it is generally known that these kinds of platforms are, to a variable extent, contributing to the spread of online counterfeiting. For example, counterfeiters are using fake Facebook profiles in order to have a screened and apparently professional internet presence allowing them to easily get in contact with potential, and often unaware, buyers. This practice is also facilitated by the fact that social networking platforms implement less sophisticated controls on the sale of products through their platforms than do, e.g., natively selling platform such as Amazon or eBay. Also, WhatsApp is reported to be increasingly used by counterfeiters to directly reach their customers and organize purchases. There is no reason to doubt that these trends are also affecting the Italian market, especially in light of the borderless accessibility of web-based content.

b. Nature of Online Counterfeiting and Infringement

Due to the increasing awareness of the authorities regarding online counterfeiting techniques, counterfeiters need to find more and more sophisticated ways to operate.

For example, a recently identified trend concerns a technique named “defacement”. In brief, in May 2014, an investigation by the Italian Financial Police – Cybercrime department revealed that 53 regular retail websites had been hacked and additional web pages had been inserted into their structure. These “stowaway” web pages then directed to websites hosting counterfeit products. The ultimate goal of this scheme, apparently, is enhancing the ranking in search engines of the websites hosting counterfeit products.

Analysts have also identified some tendencies in both online and physical counterfeiting, which appear particularly relevant.

Counterfeiters are working on raising the quality of the fake products they put into the market. Fakes are increasingly less distinguishable from originals, especially in the “Made in Italy” sector,

[7] Data gathered with reference to the product clusters “glasses” and “perfumes”. For more information, please see http://www.uibm.gov.it/attachments/indagine_contraffazione_web_convey.pdf.

where counterfeits are targeted to customers generally inclined to spend more. Accompanying documents, packaging and authenticity certificates are increasingly frequently counterfeited as well.

The price of counterfeits was once excessively low, which served as one of the most immediate and useful counterfeit indicators. In recent years, counterfeiters have grown more and more sophisticated in their pricing policies. For example, they have learnt how to smartly reduce the price spread between genuine and fake, so as to make unlawful offers less and less distinguishable.

In any event, the Italian Competition Authority (ICA) has recently[8] underlined how a significant share of users, persuaded by lower prices, deliberately purchases fake goods. This seems to denote a certain degree of social acceptance of counterfeiting practices, connected to insufficient awareness of the damage caused by counterfeiting to the national overall economy. These factors contribute to making counterfeiting particularly difficult to combat in Italy.

2. Enforcement Strategies

a. Laws Specific to Online Counterfeiting/ISP liability

Online IP infringement is not regulated by specific sets of rules, and general rules on liability for IP infringement (summarized under Part II below) also apply to online phenomena.

As to ISP liability, Italian laws are consistent with the EU framework, as set forth by the E-commerce Directive (Directive No. 2000/31/CE). The Italian legislation enacting the directive is Legislative Decree No. 70/2003.

In a nutshell, ISPs cannot in principle be held liable for their services' recipients' unlawful activities (the so-called "safe harbor" defense). This means that the full liability for IP rights infringements related to the sale of fake goods rest on users. ISPs may only be held jointly liable on the following conditions: (i) they had actual knowledge of the unlawful activity carried out by means of their services, or were aware of facts or circumstances from which it would have been apparent that the user's activity was unlawful; or (ii) upon obtaining such knowledge or awareness, they did not act expeditiously to remove or to disable access to the infringing goods.

Given that the Italian E-commerce Law expressly provides that ISPs are not obliged to actively seek facts or circumstances indicating illegal activities carried out through their services, Italian law does not expressly provide any guidance as to the meaning of "knowledge" required to trigger their liability. Italian case law has adopted discordant solutions in this regard, sometimes and sometimes not requiring the notices from IP rights holders to ISPs to have a particular form and/or content. As a general suggestion, notices sent to ISPs to report counterfeiting or other unlawful activities should be as circumstantiated as possible: e.g., including the specific URLs of all the website pages affected and any other indication useful to pinpoint the violation.

i. AGCOM Regulation on Online Copyright Enforcement

A regulation issued by *Autorità per le Garanzie nelle Comunicazioni* (AGCOM) (the Italian communications authority) gives the authority special competence and powers regarding copyright

[8] http://www.agcm.it/trasp-statistiche/doc_download/4550-audizione-20141127.html

violations committed on electronic communication networks. In particular, the regulation provides for an ad hoc administrative procedure for the assessment and discontinuance of copyright violations on the web and on audiovisual media services, mainly achieved by the direct involvement of the relevant ISPs.

An authorized subject can request intervention by AGCOM in an alleged copyright violation online, provided that the same matter is not already being discussed by the same parties before a court. The regulation defines an “authorized subject” as the owner or licensee of the copyrights in a digital work, or a third party, including any relevant association, with a proxy granted by said owner or licensee.

The regulation provides for two kinds of proceeding: an ordinary proceeding and a summary proceeding. The latter implies a shorter term, and is to be used in cases of massive violations, or in cases where AGCOM deems, based on a preliminary analysis, that the violations could seriously harm the exploitation rights of the work(s) concerned.

With reference to both kinds of proceedings, a complaint to AGCOM must be submitted through a form available on AGCOM’s website. The parties receiving notice from AGCOM of the start of the proceeding may spontaneously comply with the authorized subject’s request (in which case the complaint is dismissed), or respond to the notice within five days (or three days for a summary proceeding). An extension of this term may be granted for complex matters, but only for an ordinary proceeding. Within 35 days of receipt of the complaint (12 days for a summary proceeding), AGCOM must either reject it or order the service providers (as well as the uploader of the digital work and the webpage/website managers) to take the necessary steps to prevent the violation or terminate the same.

If the website offering unlawful digital works is hosted on servers located in Italy, AGCOM may request hosting service providers to selectively remove the works (or disable access in the case of massive violations). If the website offering unlawful digital works is hosted on servers located abroad, AGCOM may request the “mere conduit” service providers involved to disable access to the relevant website. In such cases, AGCOM may also order automatic redirection to a webpage drafted according to AGCOM’s instructions.

The relevant service providers must comply with the orders within three days of receipt of the same (two days for a summary proceeding). Lack of compliance with AGCOM’s orders triggers sanctions ranging from approximately €10,000 to €260,000.

Such procedures follow similar recent experiments in other EU countries (such as France and the UK), aimed at disabling access to infringing content, including by personally disconnecting infringers from the internet.

Compared with the remedies traditionally available to IP rights holders, the procedure introduced by the regulation is faster, and more easily accessible and cost-efficient.[9] Traditional remedies are still available to IP rights holders and law enforcement agencies, alongside the new regulation. So, in the event of copyright infringement on electronic communication networks, IP rights holders can opt for activating the new AGCOM take-down procedure and/or resort to the traditional remedies described below.

[9] Up to January 2015, AGCOM has received about 150 reports of potentially infringing content, 30 of which have resulted in an access disabling order being issued by AGCOM.

b. Other Enforcement Strategies

Apart from the copyright-specific remedy through AGCOM summarized above, the traditional remedies available to IP rights holders include the following.

Notice of infringement to ISPs: IP rights holders can notify the ISPs involved (e.g., the hosting provider of the website through which the infringement is being committed) of the infringing nature of the relevant content. This may result in the ISP spontaneously removing/disabling access to the content, in accordance with the ISP's internal policies on violation of copyrights. Such internal policies may include streamlined notice and take-down procedures (such as the one provided by YouTube). From a different perspective, the submission of a notice informing the ISP of the infringement would generally result in the ISP being unable to rely on the so-called "safe harbor" defense, which, in simple terms, excludes ISPs' liability in relation to infringing content uploaded by users, provided that the ISPs were not aware of it or had no active role in the upload/infringement.

Cease and desist letters to infringers: IP rights holders can send a cease and desist letter to infringers, informing them of their copyrights in the content uploaded/used by them, and requesting that they remove the content from the relevant platform.

Domain name dispute: Domain names having the country code ".it" may also find protection through a specific dispute resolution system that is way quicker and cheaper than any civil or criminal action. In brief, it consists of an administrative reallocation procedure to verify whether: (i) the challenged domain name is identical or confusingly similar to the trademark on which the complainant claims prior rights; (ii) the current assignee has no right, title or interest in the challenged domain name; and (iii) the domain name has been registered and/or is being used in bad faith by the current assignee. If the complainant proves the coexistence of all the above conditions, the challenged domain name shall be transferred to the complainant. The rules governing the above procedure are issued by the Registry of ".it" Internet Domains (http://www.nic.it/?set_language=en).

Civil/criminal proceedings: The IP rights holder can request the issuance of preliminary measures, and start civil or criminal action to prevent online counterfeiting (for more details, see Part II below).

Italian Competition Authority: One possible line of action that deserves particular attention is recourse to ICA. If online infringement activities also amount to a violation of Italian rules on competition and consumer protection, ICA can order that access to the relevant websites be blocked and impose substantial administrative fines.[10] The grounds on which ICA has intervened include the following.

- The rules on unfair commercial practices toward consumers, pursuant to Italian consumer protection law, in relation to which ICA can inflict administrative fines of up to €5 million. In this context, ICA has construed the sale of counterfeit as unfair toward consumers, based on the fact that the products were presented as genuine, thus

[10] In 2013, millions of counterfeit products from the fashion industry were taken off the internet, thanks to the intervention of ICA, and then seized by the police. Access has been disabled to a total of 165 websites selling counterfeit products. These included websites located inside and outside Italy and the EU. In the latter case, the access block was limited to Italian consumers, due to competence limitations. ICA has inflicted administrative fines of €1.1 million on a total of eight websites.

persuading consumers to make a purchasing decision they would not have made if fairly informed.

- The fact that the affected products contained textile materials that could cause harm to consumers.

c. Standards for Infringement

Standards for online infringements of IP rights are identical to those of offline infringements (see Part II, section 1.b).

d. Obstacles to Enforcement

There are many peculiarities of the internet environment that make it difficult to identify IP infringement. Italian commentators have directed their attention to some of them in particular.

To begin with, servers are often localized outside Italian territory. In such cases, Italian authorities are not competent to take down the source of the infringement, but can only proceed against the local *mere conduit* ISP and have access to the source blocked for Italian users.

As regards counterfeiting through social media, it is difficult to trace real identities behind "screen" profiles/avatars used to sell counterfeits to other users.

Last but not least, the ISP limited liability regime may be considered, *per se*, an obstacle in enforcement of IP rights, considering that several kinds of relevant distributors, such as online auction sites and other forms of online trade platforms, potentially qualify as ISPs and are therefore protected by the "safe harbor" defense summarized above. This factor, jointly with the inherent difficulty of tracing real identities behind online operators, often contributes to online infringements not having a concretely prosecutable culprit.

F. Spain

1. Online Infringement and Counterfeiting Trends

a. Key Sources of Infringement

Online IP rights offenses are committed on all kinds of internet sites and platforms. The most common are e-commerce platforms, social media fan pages, blogs and websites, etc.

In relation to fashion and luxury products, IP offenses on these kind of sites and platforms usually consist either of trademark infringement (offer of counterfeit/fake products; parallel imports; unauthorized use of third parties' trademarks for commercial or advertizing purposes, etc.) or of copyright infringement (unauthorized use of photographs, designs, catalogues or any other works protected by copyright that are used to advertize and to announce the offers of the branded products).

b. Evolving Nature of Online Counterfeiting and Infringement

In Spain, the methods used by counterfeiters and infringers are becoming more sophisticated. This makes offenses more difficult to detect and also makes the infringers more difficult to identify.

Some current practices used by infringers in relation to fashion and luxury goods are as follows:

- Copyright and design infringement avoiding use of brand names: These copies are more difficult to detect and enforcement of rights against them is harder.
- Use of nicknames: This makes it almost impossible to identify the infringer. Proceedings can be taken against the ISP; however, ISPs are not always deemed to be responsible for IP rights infringements.
- Use of hosting service providers domiciled in foreign countries: This creates conflicts in relation to the applicable laws and jurisdiction, making it quite complex to define the best strategy to follow.

2. Enforcement Strategies

a. Laws Specific to Online Counterfeiting/ISP Liability

There are no specific laws regarding online infringement of IP rights or online counterfeiting in Spain. However, the amendment of the Spanish Copyright Act (Law 23/2006, 7 July) transposed Directive 2001/29/EC of the European Parliament and of the Council, 22 May 2001, on the harmonization of certain aspects of copyright and related rights in the information society.

The general Spanish IP rights laws (the Copyright Act, the Trademark Act and the Design Act) are applicable to online infringement, even though they are not specific laws on online infringement.

In relation to ISPs, the Spanish E-Commerce Act (Law 34/2002, 11 July, which transposed Directive 2000/31/EC of the European Parliament and of the Council, 8 June 2000, on certain legal aspects of information society services – in particular, electronic commerce – in the internal market) is applicable to ISPs established in Spain and to the services provided by such ISPs in Spain, and also to the services provided in Spain by any ISP domiciled in a foreign country but permanently established in Spain.

In general terms, as concerns ISP liability:

- ISPs that provide purely technical services, such as access to the internet, are not liable for the content and/or information transmitted, except in those cases where ISPs do actively participate in the transmission and/or selection or alteration of the information or the recipients of the information.
- Hosting service providers and providers of links to content or search engines are not responsible for the content and/or information, except in the event that (i) they have effective knowledge of the illicit nature of such content; or (ii) if they are aware of the illicit nature of the content, and do not exercise due diligence to remove or restrict access to the illicit content. There has been recent debate in relation to the criteria of "effective knowledge". Traditionally, it was limited to the fact that a competent authority declares the unlawfulness of the data and the provider has knowledge of that decision. However, recent case law has extended such criteria to the ISP becoming aware by other means of the illicit nature of content.

In conclusion, both IP laws and e-commerce laws must be taken into consideration when taking any action against online IP rights offenses.

b. Other Enforcement Strategies

The following are examples of current enforcement strategies applied by IP rights owners: conducting private investigations (either by an internal or external investigator); conducting test purchases, in order to confirm the nature, composition and origin of the goods offered through determined internet sites or platforms; using the take-down notices or IP complaint procedures already existing in many platforms; sending cease and desist letters to the infringer using the internet sites (in the event such user is identified) or to the party responsible for the internet sites or platforms where the infringement is taking place; starting domain name dispute resolution procedures; taking action to request that the relevant ISP stop its services: e.g., the blocking or cancellation of the website where the infringement is taking place, the cancellation of the relevant domain name.

Finally, there is a new administrative procedure in Spain, which is processed through the Spanish Intellectual Property Commission and the objective of which is mainly to stop copyright infringement on the internet. As a result of the procedure, the Intellectual Property Commission, in coordination with the Spanish courts, may order the closure of the ISP.

c. Standards for Infringement

The most common IP online infringements in Spain are the following: sale of counterfeit products and parallel imports, in relation to trademark infringements; and unauthorized copies of designs and shapes (protected by copyright) of the products without the use of the brand, and unauthorized use of photos protected by copyright, in relation to copyright infringement.

d. Obstacles to Enforcement

Again, the main obstacles to enforcement are the following:

- identification of the infringer;
- applicable law and jurisdiction conflicts – there are plenty of cases in which the ISP and the infringers are domiciled in countries other than that of the injured party;
- obtaining evidence of the infringement – most of the internet sites or e-commerce platforms offer sales of different branded products for a limited period. Usually, they are weekly offers. This means that the products sold through these kinds of websites change constantly; and
- proving that the ISP had effective knowledge of the illicit nature of the content, in order to deem it liable for the transmitted or hosted illicit content, is not always easy. Lack of evidence in this regard would definitely diminish the chances of success of any action taken against the ISP.

G. Russia

1. Online Infringement and Counterfeiting Trends

a. Key Sources of Infringement

In Russia, the most common violation of trademark exclusive rights on the internet is the placement of a registered trademark, or selling/advertizing of goods bearing a registered trademark, on a website without permission from the trademark owner. This kind of trademark infringement can be committed on stand-alone websites and on social networks. A stand-alone issue is replica websites, offering for sale copies of various luxury products (e.g., luxury watches, bags, shoes and other accessories).

A considerable number of disputes involve use of trademarks in domain names. Domain names are not listed among IP assets, and the right to use a trademark in a domain name is one of the prerogatives of the trademark owner.

A separate area of disputes involves questions of liabilities of third parties – namely, ISPs – for the infringement of IP rights (including trademarks) committed by domain owners and file-sharing networks.

b. Evolving Nature of Online Counterfeiting and Infringement

Although unauthorized use of trademarks in online advertisements violates trademark owners' rights, the Russian courts do not perceive the use of trademarks as keywords in contextual advertizing as infringing, as the keywords do not identify one and only one advertiser. At present, it is unlikely that an unlawful advertiser or the search engine owner could be held liable for trademark infringement.

2. Enforcement Strategies

a. Laws Specific to Online Counterfeiting/ISP Liability

Russian legislation provides a framework where online counterfeiting falls within a general counterfeit liability category, by stating that unauthorized use of trademarks on the internet, including domain names, is an infringement of one's exclusive rights.

While Russian law generally does not provide for a specific liability regime for persons directly or indirectly engaged in online counterfeiting, the legal remedies available to the exclusive rights owner may well befit the nature of the infringement, as indicated below.

i. ISP Liability

In 2013, the Russian Civil Code was supplemented by regulations setting forth the liability of information intermediaries (ISPs). An ISP is defined as "an entity that carries out the transmission of content in information and telecommunication networks, including on the Internet; an entity that enables the distribution of the content by use of information and telecommunication networks (or distribution of information required to obtain such content); an entity that enables the access to the content in such networks".

An ISP can be held liable for unlawful distribution or making protected content accessible, unless it can demonstrate that it falls within the scope of the legal exemptions from liability.

ISPs that enable access to protected content can be exempted from liability if the following conditions are met:

"(1) they did not initiate the transmission of the content and did not determine the receiver of the content; (2) did not modify the content while providing services, save for the changes necessary by the technical process of transmission; (3) did not know, or should not have known, that the use of the results of intellectual activity by the entity who had initiated the transmission of the content comprising such results was unlawful." (paragraph 2 of article 1253.1 of the Civil Code of the Russian Federation).

ISPs that have enabled content distribution over the internet can be exempted from liability if:

"(1) they did not know, or should not have known, that the use of the results of intellectual activity by an entity that initiated the transmission of the content subsisting in the content at issue was unlawful; (2) promptly undertook necessary and sufficient measures to stop the violation of intellectual property rights upon the receipt of the notification from the rights holder containing indication of a webpage of the website and/or IP address." (paragraph 3 of article 1253.1 of the Civil Code of the Russian Federation).

b. Other Enforcement Strategies

A potentially powerful enforcement strategy in the case of online infringement is the notice and take-down procedure recently introduced in Russia, which has very fast and effective tools for taking down infringing online content. Even though the procedure currently applies to audiovisual works (e.g., films, cartoons and clips), it may be helpful in defending trademark exclusive rights as well.

Unauthorized resellers and counterfeiters tend to use official promotional materials, like high-quality videos and images, and company logos, on their websites. As of August 2013, the notice and take-down procedure is available in regard to movies and TV shows. Ever since the new law providing for such measures came into force, it has proven to be an effective means of exclusive rights enforcement. Starting from 1 May 2015 the procedure will become applicable to any works protected by copyright or neighboring rights (with the exception of photographs).

Under the notice and take-down procedure, the exclusive rights owner is entitled to file with the Moscow City Court a request for provisional remedies aimed at blocking unauthorized content placed on the internet. Rights holders are only obliged to provide evidence of the exclusive rights ownership and placement of the allegedly infringing materials. A request may be filed online via the website of the Moscow City Court. The court then issues an order obliging the alleged infringer to take the content down or get the whole website blocked. The exclusive rights owner has 15 days to file a suit with the Moscow City Court; otherwise, the material will be back online.

Other enforcement strategies may turn out to be just as effective. In the last few years, quite a few legislative acts to ensure protection of exclusive rights have come into force in Russia.

c. Standards for Infringement

The standards for infringement on the internet are practically no different from the standards applicable offline, which will be outlined below. Consequently, online and offline use of a trademark on goods offered for sale or sold, or in advertisements, constitutes an infringement. Exclusive right owners are also granted protection against use of their trademarks in domain names – use of a trademark in a domain name is explicitly recognized as a type of trademark use and requires consent of the trademark owner.

d. Obstacles to Enforcement

It is often quite difficult to identify the legal entity or person behind online counterfeiting activities. Most often, counterfeiters use schemes where a natural person unrelated to the operator of an infringing website is the owner of the domain name. Should the website be shut down, the unauthorized distribution channel stays mostly intact. Further, online stores selling counterfeit products may often be using various special purpose companies with no assets to issue invoices to customers.

Moreover, police enforcement is hindered by the oft-reported police inability to effectively handle online counterfeiting cases. It is quite complicated for the police to find and raid storage facilities to block the flow of counterfeit goods if the scheme relies on online distribution.

Overcoming such obstacles may require substantial expenditure, with the result largely uncertain.

H. United States

1. Online Infringement and Counterfeiting Trends

a. Key Sources of Infringement

There are many thousands of stand-alone counterfeit websites offering infringing/counterfeit goods to U.S. residents. Often, foreign-based infringers/counterfeiters set up counterfeit websites appearing to be U.S. or Canadian-based, to seem legitimate when they are not. Infringing/counterfeit goods are routinely offered and sold on auction sites (eBay) and e-commerce platforms (Amazon, Alibaba, AliExpress, Craigslist, Taobao, etc.). Infringers/counterfeiters are increasingly offering or advertizing counterfeit goods through social networking services and platforms (blogs, Reddit, Facebook), instant messaging services (WhatsApp, WeChat, etc.), mobile device applications and other social networking services and platforms.

b. Evolving Nature of Online Counterfeiting and Infringement

Infringers/counterfeiters are increasingly sophisticated. They are getting better at copying IP rights (IPR) owners' overt counterfeit indicia (holograms and other complex devices). They separate their manufacturing and assembly divisions, so that members of their teams have no access to other members' identities, knowledge and/or duties. They import counterfeit goods differently (small packages sent via overnight carriers or mail, versus large packages sent by air or containers shipped by sea). They alter their assembly process (separately import parts, labels, etc., into the U.S., versus importing fully assembled counterfeit goods in full packaging. They evade price filters (and consumer scepticism) by pricing the counterfeit goods close to the purchase price of genuine goods and/or offer similar discounts as the IPR owners. They import products into the

U.S. through perceived “safe” countries (e.g., Canada) and through perceived easier entry points. They avoid using brand names/marks in domain names and on their websites.

2. Enforcement Strategies

a. Laws Specific to Online Counterfeiting/ISP liability

The Anticounterfeiting Consumer Protection Act (ACPA) provides enhanced statutory civil penalties for trafficking in counterfeit goods. The Anticounterfeiting Trade Agreement (ACTA) provides means for IPR owners in various countries to pursue global counterfeiters. The U.S. is a signatory to ACTA. The Digital Millennium Copyright Act (DMCA) increased penalties for copyright infringement on the internet. Under DMCA, there is no liability for ISPs that adhere to DMCA’s safe harbor guidelines, promptly block access to allegedly copyright-infringing materials, or remove the material from the ISPs’ systems when they receive notice of an infringement claim from a copyright owner.

b. Other Enforcement Strategies

In the U.S., IPR owners use various enforcement strategies. These include regular searches on websites, blogs, auction sites and e-commerce sites (eBay, Alibaba, Aliexpress, Taobao, etc.), and targeted purchases on websites, auction sites and e-commerce sites. IPR owners seek, receive and follow up on information from their customers and/or third parties about counterfeit websites and activities. They use the UDRP to remove or obtain infringing and/or counterfeit domain names quickly and at low cost. Some IPR owners register their copyrights and trademarks with certain ISPs that offer advance registration to streamline take-down requests. They send complaints and take-down requests to ISPs complying with the ISPs’ identified take-down procedure.

c. Standards for Infringement

IPR owners may pursue infringers/counterfeiters through federal and state courts in the U.S. If they do so, they must meet the those courts’ standards for infringement (see Part II (1)(b) below). If they pursue counterfeiters using a UDRP proceeding, they must submit evidence of their trademark, the counterfeiter’s bad-faith activities and the likelihood of confusion.

d. Obstacles to Enforcement

IPR owners face various obstacles pursuing online counterfeiting/infringement in the U.S. Difficulties include a faster internet, consumers’ desires to receive products almost instantly, and difficulty identifying infringers/counterfeiters. Often, counterfeiters provide false information to ISPs and other third parties about their identity, location and other key details. They also register new domain names and websites containing different information to make it difficult to follow them and/or associate them with other members of a counterfeiting ring. Sometimes, lower-level members of a counterfeiting ring do not know or will not reveal information about persons higher up the chain (e.g., manufacturers, assemblers and importers). In addition, the lower-level members of a counterfeiting ring may not have significant financial assets to pursue. Even if they are pursued, some counterfeiters quickly show up on the internet again, under new names and/or on new websites.

I. Canada

1. Online Infringement and Counterfeiting Trends

a. Key Sources of Infringement

Online infringement and counterfeiting in Canada occur through a variety of means. Disputes can involve sales conducted through stand-alone counterfeit sites or through legitimate websites offering counterfeit goods for sale; source examples include online auctions and sales sites such as eBay, social media sites and posts, and banner advertizing. Others involve more clandestine means of trading in counterfeit or infringing products. Infringement can also be found via meta tags or pay-per-click advertizing.

b. Evolving Nature of Online Counterfeiting and Infringement

Businesses now recognize that social network sites present growing channels of trade to promote products and cultivate customers. Such sites therefore present increasingly ripe fodder for infringement and counterfeiting activities.

Although not specifically targeted to online counterfeit activities, Canadian legislation is in the process of being amended to provide mechanisms to try to assist in combating counterfeit trafficking across Canadian borders, including online sales and distribution (discussed below). Specifically, on 9 December 2014, Royal Assent was given to Bill C-8, the Combating Counterfeit Products Act. The amendments in the Act will provide, among other things, new mechanisms for enforcement (i.e., new criminal offenses and new provisions giving customs officials powers to seize and detain suspected counterfeit goods), and additional remedies for trademark and copyright owners. It is expected that the new Act will come into force in late 2015 or early 2016.

2. Enforcement Strategies

a. Relevant Legislation

i. Proposed Legislative Changes

As discussed above, Royal Assent has been given to Bill C-8, the Combating Counterfeit Products Act. This Bill (initially introduced by the Federal Government in March 2013 as Bill C-56) seeks to expand the criminal provisions of the Copyright Act to include new offenses, introduce criminal offenses under the Trademarks Act, and amend the Criminal Code to allow for judicial authorization of wiretaps to investigate the new offenses. The Act should also create new civil causes of action for the sale or distribution of counterfeit goods, packaging and labeling used for counterfeit goods, and infringing copies of copyrighted works. It will also set out a procedure by which copyright and trademark owners can request assistance from border customs officers to detain potentially infringing goods and provide information about the detained goods to the owner of the trademark or copyright.

Copyright Act

Provisions of the Copyright Act that impose civil and criminal liability for dealing in counterfeit goods have been applied in the online landscape. The Copyright Act sets out two types of infringement: direct (primary) and indirect (secondary). Direct infringement is not defined by a list of acts that constitute infringement, but by reference to the rights conferred to the owner of the copyright or the author. Secondary infringement is usually directed to unauthorized dealing with infringing works.

Section 27(1) of the Copyright Act provides that infringement occurs when a person does, without consent or license of the owner, anything that the owner is permitted by the Act to do with the copyright, including, with respect to a work, to produce or reproduce the work or any substantial part thereof in any material form whatever, to perform the work or any substantial part thereof in public or, if the work is unpublished, to publish the work or any substantial part thereof. The rights ascribed to copyright owners are more specifically set out in sections 3, 15, 18, 21 and 26 of the Copyright Act.

Under sections 27(2) to 27(5) of the Copyright Act, secondary infringement occurs when a person sells, rents out, distributes, exposes or offers for sale or rental, or exhibits in public, a copy of a work, sound recording or fixation of a performer's performance or a communication signal that the person ought to have known infringes copyright. Infringement also occurs when a person possesses or imports a work into Canada for any of these purposes. Since knowledge is required, ignorance may constitute a valid defense.

Subsection 42(1) of the Copyright Act ascribes criminal penalties for secondary infringement, which is of particular importance in combating the distribution of counterfeit works. Given the global nature of e-commerce, the prohibitions against the import and export of counterfeit products may be of particular interest to copyright owners. Section 44 of the Copyright Act provides that copies made outside of Canada of any work in which copyright subsists that, if made in Canada, would infringe copyright, shall not be imported. Sections 44.1 to 44.4 detail the court's powers for preventing the importing of copyrighted works, including orders for interim custody by customs officers. Other provisions of the Act are also directed at prohibiting the importing of specific items; for instance, paragraph 27(1)(e) deems it an infringement to import, for the purpose of selling, renting, distributing, offering for sale or rental, or exhibiting in public, a copy of a work, sound recording or fixation of a performance or communication signal that the importer knows or should have known infringes copyright or would infringe copyright if it had been made in Canada.

Finally, subsections 27(2.3) and 27(2.4) apply specifically to conduct in the online landscape. Subsection 27(2.3) provides that "[i]t is infringement of copyright for a person, by means of the Internet or another digital network, to provide a service primarily for the purpose of enabling acts of copyright infringement if an actual infringement of copyright occurs by means of the Internet or another digital network as a result of the use of that service". The factors to be considered in determining whether such an infringement has occurred are set out in subsection 27(2.4).

Trademarks Act

Unlike the Copyright Act, Canadian trademark legislation does not contain provisions *specific* to online counterfeiting or infringement; however, certain provisions of the Trademarks Act impose liability for dealing in counterfeit goods, which have been *applied* in the online landscape.

Canadian trademark legislation is also in the process of being amended and Royal Assent was given on 19 June 2014 to Bill C-31, which, among other things, proposes significant changes to the Canadian Trademarks Act. The most notable changes that will be made deal with the criteria to register trademarks in Canada. More significant changes regarding counterfeit goods appear to be addressed in Bill C-8 (discussed above). Again, it is expected that the new Trademarks Act will come into force in late 2015 or early 2016.

Presently, the Trademarks Act does not contain provisions criminalizing the import of counterfeit goods. However, a number of provisions establish civil liability, which remains equally applicable in the online and offline landscape. For instance: section 7 of the Trademarks Act prohibits the passing off of goods; section 19 captures use by a defendant of a trademark identical to the plaintiff's mark; section 20 captures use of marks or trade names that are *confusing* with the owner's mark by deeming infringement of a registered mark owner's exclusive rights if a person not entitled to use the mark sells, distributes, or advertizes wares or services in association with a confusing trademark or trade name; and section 22 prohibits individuals from conduct that is likely to have the effect of depreciating the value of the mark owner's goodwill.

An interested person may apply to a court to determine that a registered trademark or trade name has been imported into Canada or is about to be distributed in a manner that constitutes trademark infringement. In such a situation, the court may make an order under section 53(1) of the Trademarks Act for the interim custody of the wares by the Canada Border Services Agency, pending a determination of the legality of their import or distribution. An applicant may also seek a court order, under section 53.1(1), directing the Minister of National Revenue to take reasonable measures to detain wares that are about to be imported into Canada or that have been imported into Canada but have not yet been released. If the court is satisfied that the import or distribution of the impugned goods would be contrary to the Trademarks Act, it may, under section 53.1(7), make any order that it considers appropriate, including ordering that the wares be destroyed or exported, or that they be delivered to the plaintiff as the plaintiff's property.

Bill C-8 is expected to expand the Trademarks Act to include criminal offenses for infringement. Section 51.01 sets out the new offenses, which relate to the sale and manufacture of infringing goods, the sale or advertisement of services in association with an infringing mark, and the manufacturing, possession, importing or exporting of labels or packaging to be used in association with infringing goods.

Canada Consumer Product Safety Act

Section 7 of the Canada Consumer Product Safety Act prohibits manufacturers or importers from manufacturing, importing, advertizing or selling a consumer product that is a danger to human health or safety, is the subject of a recall order or is the subject of a measure that the manufacturer or importer has failed to carry out as required. Section 9 of the Act prohibits anyone from packaging or labeling a product in a manner that is false, misleading or deceptive to the extent that it may create the impression that the product is safe or that it complies with a safety standard or regulation.

Criminal Code

In addition to criminal liability under the Copyright Act, the Canadian Criminal Code contains a number of offenses under which individuals dealing in counterfeit goods may be prosecuted, including forgery, passing off or fraud relating to trademarks, which are contained in sections 380 and 406-412. However, the standard of proof in criminal prosecution remains higher, as the accused must be shown beyond a reasonable doubt to have committed the offense.

b. Other Enforcement Strategies

i. Domain Name Disputes

In Canada, the courts have considered whether incorporating another entity's trademark or corporate name in a domain name can infringe the rights of others. Typically, incorporating a mark/name in a domain name would be insufficient to constitute "use" of a trademark as defined in the Canadian Trademarks Act. That said, if the site also depicted counterfeit goods, then a cause of action could likely be established.

To help resolve the myriad conflicts related to the registration of domain names, the Canadian Internet Registration Authority (CIRA) adopted a dispute resolution policy for .ca top-level domains (i.e., the CIRA Dispute Resolution Policy (CDRP)), which sets out the legal framework for the resolution of disputes between a .ca domain name registrant and a third party over the abusive registration and use of an internet domain name.

CDRP is similar to the Internet Corporation for Assigned Names and Numbers (ICANN) policy (which deals with, among others, .com and .net top-level domains). Proceedings under CDRP do not prevent the registrant or complainant from submitting the dispute to a judicial trier of fact, or any other procedure, at any time for resolution.

A registrant must submit to a CDRP proceeding if a complainant asserts that the registrant's .ca domain name is confusingly similar to a mark in which the complainant had rights prior to the date of registration of the domain name (and continues to have such rights), the registrant has no legitimate interest in the domain name, and the registrant has registered the domain name in bad faith.

Two of the more common bad faith activities that have been subject to successful CDRP domain name transfers include: registrants selling goods belonging to the complainant via sites purporting to be the complainant's official site; and (ii) registrants registering domain names that incorporate the complainant's well-known marks and then using them to sell counterfeit products bearing the complainant's marks or marks similar thereto. As an example, in *Oakley Inc. v. Yayang*, 2012 CarswellNat 1418 (CIRA), the registrant registered the domain name "discount-oakleysunglasses-sale.ca", through which it proceeded to sell counterfeit Oakley sunglasses. The CIRA panel ordered that the registration be transferred to the complainant when it determined that, by incorporating the complainant's well-known mark, the domain name was likely to lead individuals visiting the website to believe that it was associated with the complainant and that the sunglasses were indeed the complainant's well-known Oakley-brand of sunglasses. The panel found that combining the words "discount", "sunglasses" and "sale" increased the likelihood of confusion, given the complainant's well-known high-end sunglasses business.

ii. Contempt Orders

While not limited to the online landscape, contempt orders have been issued by courts in the context of online infringement or counterfeiting in the event that all other order enforcement mechanisms have been unsuccessful and the other party is in breach of an order. However, because this mechanism poses severe compromise to the freedom and financial interests of the impugned party, courts are reluctant to effect such orders, and will do so only in the clearest of cases where it is beyond a reasonable doubt that the alleged contemnor deliberately and willfully disobeyed a clear order, and only where the alleged contemnor has had proper notice of the contempt motion.

Civil contempt (i.e., disobedience of the civil process) will most often invite a coercive penalty of a fine, injunction, striking out of pleadings and/or orders for costs, none of which are intended to be punitive. Where there is active public defiance or recidivist acts of contempt, the court may impose imprisonment. Criminal contempt, which obstructs or is intended to obstruct the administration of justice and has more public repercussions, is sanctioned by higher fines or imprisonment, which are intended to be punitive. Examples of Federal Court cases where contempt orders have been issued include the following.

- In *LifeGear Inc. v. Urus Industrial Corp*, 2004 FC 21, the plaintiff owned the trademark SATURNE, used in association with elliptical trainers. The defendant sold counterfeit elliptical trainers under the "Saturne" name. An order was issued prohibiting the defendant from, among other things, further advertizing the offending product and the delivery up of infringing materials to the plaintiff. On its failing to comply, the court held the defendant in contempt and ordered the defendant to pay costs.
- In *Dursol-Fabrik Otto Durst GmbH & Co. v. Dursol North America Inc.*, 2006 FC 1115, after they failed to comply with an order enjoining the defendants from selling the plaintiff's products, the court found the defendants in contempt and ordered that they pay a fine of C$20,000 (as well as the plaintiff's costs) within 14 days or be imprisoned until the fine was paid.

c. Standards for Infringement

Standards for infringement in the online landscape are the same as in the offline landscape, with the exception that domain name disputes are necessarily restricted to the online world.

i. Domain Name Disputes

CDRP (discussed earlier) has a limited and narrow scope, and only deals with bad faith registration of domain names, not disputes involving broader issues of IP infringement. Whether a domain name is IP or merely a right purchased by a domain owner is not yet clearly decided. But a bad faith registration is not infringement *per se*. Where a domain name incorporates another's trademark, then the standard for trademark infringement would apply, as discussed below.

Paragraph 3.1 of CDRP sets out the test that must be met in order for a domain name to be transferred to a complainant: (1) the registrant's .ca domain name must be "confusingly similar" to a mark in which the complainant had rights prior to the registration date and to which the complainant continues to have rights; (2) the registrant has no legitimate interest in the domain name; and (3) that the registrant has registered the domain name in bad faith. Paragraph 3.4 of CDRP lists six factors that would support a complainant's legitimate interest in the domain name, and paragraph 3.5 sets out four situations that would suggest a registrant registered a domain name in bad faith.

ii. Trademark Infringement

The standard for infringement will depend on whether the mark of the original owner is registered. Presently, sections 19, 20(1) and 22 of the Trademarks Act set the framework by which infringement is determined vis-à-vis a registered mark: section 19 prohibits use of an identical trademark in association with the wares and services in respect of which the mark is registered; section 20 encompasses the protection afforded by section 19, and, more broadly, provides a trademark owner with a course of action against anyone using a trademark or trade name that is likely to cause confusion (liability under this section is not limited to the exact marks, wares and services of the registered owner); section 22 provides liability when someone uses the registered owner's mark in such a way as to likely depreciate the value of the goodwill attached to the trademark.

Where trade indicia are the subject of a license, the licensor will most often be the proper defendant, even if not using the indicia, unless the licensee has added material to the indicia, which added material is the cause of infringement (in which case, the registered owner should join the licensor as a defendant in the action, or else risk *res judicata* preventing a subsequent action against the licensor). Knowingly and deliberately aiding and abetting another's infringement, even if not directly infringing by one's actions, will ground liability. All entities in the "chain of infringement" who are responsible for putting the infringing wares on the market, including those that then deal in the infringing wares, are subject to liability for infringement.

However, to ground infringement, the "use" of the identical or confusing mark must come within the ambit of "use" as defined in section 4 of the Trademarks Act and must be "use" *as* a trademark. Under section 4, "use' in association with wares is deemed if, at the time of the transfer of the property in or possession of the wares, in the normal course of trade, the trademark is marked on the wares or on the packaging, or it is in any other manner so associated with the wares that notice of the association is then given to the person to whom the property or possession is transferred. As regards services, a trademark is deemed to be used in association with services if it is used or displayed in the performance or advertizing of those services. Finally, a trademark that is marked on wares or packaging is deemed used in Canada when the wares are exported from Canada.

As noted above, the Trademarks Act presently contains a number of provisions intended to protect the exclusive rights of mark owners. Although these provisions are not limited in application to the online landscape, they have been applied to cases involving counterfeit products and infringement on the internet. Many of the cases involve marks that are determined to be confusing, as prescribed under subsection 6(5) of the Trademarks Act, although certain cases of infringement have involved the use of the owner's exact mark.

In *Louis Vuitton Malletier S.A. v. Singga Enterprises*, 2011 FC 776, the defendants were found to have manufactured, imported, advertized and sold counterfeit and infringing fashion accessories bearing Louis Vuitton and Burberry marks. The products were sold through a physical warehouse and through two websites. The defendants were found to have infringed a range of provisions under the Trademarks Act, including sections 7, 19, 20, and 22.

In *Driving Alternative Inc. v. Jarvis*, 2012 FC 1430, the plaintiff owned the KEYS PLEASE mark in association with providing driving services. The defendant advertized and offered driving services on Facebook under the business name KEYZ PLEEZZ. The defendant was found to have engaged in trademark infringement, passing off, and depreciating the plaintiff's goodwill.

In *Microsoft Corp v. 9038-3746 Quebec Inc.*, 2006 FC 1509, the defendants operated a computer software business and imported and sold compact disks containing copies of various Microsoft software programs, which were not purchased from Microsoft or an authorized distributor of Microsoft. The goods were offered for sale on the defendant's website. Microsoft brought an action alleging both copyright and trademark infringement. Microsoft argued that, even if the software on the disks and accompanying material were genuine, the defendant's dealings in them were unlicensed and an infringement of its copyright and trademarks. The defendants argued that they were dealing in the "gray market", such that they had not infringed any of Microsoft's rights. The court agreed with Microsoft, holding, at paragraphs 1-2, that the impugned materials were counterfeit in that "they were neither manufactured by Microsoft nor by any of its authorized replicators". Consequently, the defendants were held to have passed off counterfeit wares, contrary to section 7 of the Trademarks Act. Because Microsoft had the exclusive right to use its trademarks throughout Canada, the defendants had also engaged in infringement under section 20 of the Trademarks Act.

iii. Copyright Infringement

Legislative standards for infringement are provided above, at section 2.1(b). Provisions of the Copyright Act have also been applied to prevent online infringement.

In *Louis Vuitton Malletier S.A. v. Singga Enterprises*, 2011 FC 776, the court held that the defendants, in importing and trading in counterfeit wares, had violated sections 3 and 27 of the Copyright Act.

In *R. v. M. (J.P.)*,1996 NSCA 108, the appellant had been engaged in peer-to-peer sharing of copyrighted computer programs. The appellant was found to have posted the programs onto online bulletin boards and allowed access to them by modem, and was subsequently found guilty of copyright infringement, contrary to paragraph 42(1)(c) of the Copyright Act. The Court of Appeal made it clear that computer programs were expressly protected by the Copyright Act as literary works, and that the appellant had created infringing copies by posting them online and had distributed the infringing copies by allowing others to download them from his computer.

In *Koslowski v. Courrier*, 2009 FC 883, the plaintiff, who was the author and originator of "THE3GEEKS" comic book characters, alleged that the defendant, who owned and operated a computer sales and repair business in Ontario, had displayed infringing images on its websites involving "THE3GEEKS" characters. The court held that the defendant had engaged in copyright infringement, contrary to sections 3 and 27 of the Copyright Act.

Adobe Systems Inc. v. Thompson, 2012 FC 1219, involved plaintiffs who were well-known US developers of software programs and who owned copyrights in their programs and licensed them to a wide range of licensees. The defendant was found to have engaged, contrary to the Copyright Act, in unauthorized reproduction of the plaintiffs' products when it offered these unauthorized reproductions for sale on the Kijiji and Craiglist websites. The defendants were also found to have assisted purchasers of the pirated software by supplying instructions and product keys for activating the software on their own computers.

iv. Criminal Code Proceedings

In addition to the civil causes of action set out above, as well as the criminal provisions set out in the Copyright Act, Canada's Criminal Code contains sanctions against trademark infringement in the context of forgery and fraud. However, unlike in civil proceedings, the elements of each charge under the Criminal Code, including those related to counterfeits, must be proven beyond a reasonable doubt.

d. Obstacles to Enforcement

Criminal proceedings relating to online infringement and counterfeit goods are subject to a higher standard of proof – beyond a reasonable doubt. Relying on criminal prosecution of online infringement entails a loss of control on the part of the mark or copyright owner, as the police and the Crown have discretion in determining whether to pursue an investigation or charge. Even where the police may be persuaded to become involved in criminal prosecution of counterfeiting, limited resources may hinder police agencies' attempts to enforce the relevant statutes.

In the civil context, there has been at least one case in which the infringing party's corporate form hindered enforcement. In *R. v. AFC Soccer*, 2004 CarswellMan 212 (Man. CA), the defendant offered for sale what it purported to be UMBRO-brand jerseys. Sales were conducted at the defendant's bricks-and-mortar stores and through its website. The defendant was aware that the wares were counterfeits, and pled guilty at trial to copyright infringement under paragraph 42(1)(a) of the Copyright Act. However, the conviction was quashed by the Court of Appeal because "AFC Soccer" was the company's business name but not their legal name. The Court of Appeal held that, because a business name is not a legal entity under any of the relevant statutes at issue, the conviction of AFC Soccer could not be upheld. It is unclear whether the case was re-tried with a properly named defendant.

Finally, in at least one case, the court's insistence on applying traditional statutory interpretations to the online landscape hindered the ability of a trademark owner to enforce its rights. In *Pro-C Ltd. v. Computer City Inc.*, 2011 CarswellOnt 3115 (Ont. CA), the plaintiff owned the mark "Wingen", which covered its software products and was used as the name of the plaintiff's website. The defendants adopted the "Wingen" name in association with personal computers sold in the U.S., and its website offered information relating to its Wingen computers. After the plaintiff alleged that the defendant had engaged in infringement contrary to section 20 of the Trademarks Act, the court noted that section 20 depended upon infringing "use" of the plaintiff's mark, and held that, because the defendant's website was passive and offered only information, there was no possibility that wares would transfer ownership through the website. As such, the defendant's website was held not to constitute "use' in Canada within the meaning of the Trademarks Act.

J. Mexico

1. Online Infringement and Counterfeiting Trends

a. Key Sources of Infringement

In Mexico, the main sources for online infringement and counterfeiting are e-commerce platforms and auction sites, social networking services and other infringing websites, including those operated with hijacked domain names.

b. Evolving Nature of Online Counterfeiting and Infringement

As the transactional flow of e-commerce has been growing steadily, online counterfeiting and infringing actions have also experienced a significant increase, causing an evolution in consumer habits. It is worth mentioning that in Mexico use of the internet has increased from 2012 to 2013 by 13 percent, which will escalate in the coming years. This growth, combined with other circumstances, such as the lack of administrative regulations and restraints, as well as the availability of commercial platforms for e-commerce, has caused the demand for all goods, including counterfeit and illicit ones, to soar.

2. Enforcement Strategies

a. Laws Specific to Online Counterfeiting/ISP Liability

The Mexico Industrial Property Law and Copyright Law do not foresee liability for ISPs or provide any safe harbors. Please note that both of these acts were enacted and have been in full force and effect since the mid nineties, without any major amendment related to the digital environment. Recent amendments to the Federal Telecommunication and Broadcasting Law have shed new light on the possibility of raising blocking injunctions with the competent authorities.

The current provisions of the general legal framework derived from the Federal Telecommunication Law could be interpreted to allow the ISPs to obey and initiate take-down procedures, be part of an IP infringement action, disclose relevant information upon administrative or judicial request, and be part of injunctions, which creates a favorable scenario for IP titleholders, increasing the rule of law to protect these rights. However, due to the newness of these amendments, there has not been any case law that sets forth the scope of the involved rights or how these new legal provisions will be enforced on a day-to-day basis.

b. Other Enforcement Strategies

The most common strategy is to implement periodic review of the main websites, social networks, auction websites, etc., to learn if there is any commercialization or use of any type of products that infringes the IP of the rights holders, as well as maintaining a close relationship with the auction sites' administrators and building a database of the infringers to ensure speedier enforcement. It is noteworthy that in Mexico the domain name dispute resolution procedures (UDRP and LDRP) have been strengthened during the last years, because of the great impact of hijacked domain names, which has been an unfortunate trend during the same period.

c. Standards for Infringement

In Mexico, the standard for infringement is that the affected titleholder has the burden of proof of showing that the infringing product bears a trademark, slogan or design that is confusingly similar to the registered right, and has to prove the existence of consumer confusion. The titleholder's burden of proof consists of proving the following:

- the existence of a local registered right, which is entitled to protection under federal copyright law or the Industrial Property Law;
- that the alleged infringer used the same or a similar trademark in commerce, covering goods in the relevant class, without consent from the titleholder; and
- that the infringing trademark could create confusion in the consumer in the marketplace, which is usually inferred from the likelihood of confusion test.

d. Obstacles to Enforcement

One of the main obstacles that rights holders face when dealing with online infringement is the difficulty of identifying the infringers and their exact location. An additional hurdle in enforcement is that authorities are not used to prosecuting actions against online infringers. Finally, it should be noted that the legal framework needs thorough amendments to acknowledge these types of infringements in the digital environment, with proper and adequate regulations and streamlined enforcement actions, including measures to rapidly locate IP address information, tracing digital routes, etc.

K. Argentina

1. Online Infringement and Counterfeiting Trends

In Argentina, the trend of selling counterfeit fashion and luxury goods, as well as gray products, online is increasing. The existence of online platforms is making it more difficult to track and identify retailers and parallel importers as well as to file actions against them. Some of the sites where counterfeit fashion and luxury goods are most commonly sold are online retail sites such as MercadoLibre and OLX, and social networking services such as Facebook or blogs.

As far as counterfeit products are concerned, it is customary for users/sellers on online retail platforms to identify their products with renowned trademarks, in order to match the search criteria of possible buyers. Even though some of these platforms have IP programs to protect registered trademarks and logos, the process of taking down posts in which sellers infringe IP rights is burdensome and full of requirements. Besides, the online retail platforms parameters to analyze whether IP rights are being infringed are not very clear.

In turn, the retail of gray products, i.e., parallel imported goods, is becoming more common in Argentina, partly due to the restrictions imposed on the importation of goods. It should be noted that the purchase of these products is done more through blogs than online retail platforms. Registered trademarks and logos are used to advertize the sale of these goods.

Consequently, in both cases, there is vast use of registered trademarks and logos to advertize counterfeit goods and parallel imported products.

2. Enforcement Strategies

a. Enforcement in the Online/Offline Landscape

Possible Actions before Filing a Civil or Criminal Infringement Court Action

i. Cease and Desist Letter

A cease and desist letter may be sent to retail stores or manufacturers that allegedly commercialize infringing products. This is a formal notice, not only advising the infringers that they are dealing with infringing products, but also indicating who is authorized to commercialize legitimate products (e.g., licensees).

ii. Preliminary Injunction

This action, established by article 38 of Argentina's Trademark Law No. 22.362, is based on a court order that directs a court officer to draw up an inventory with a description and/or seizure of all of the infringing products found on the premises. Depending on the magnitude of the infringement, it may be advisable to seize a sample of the infringing products or attach all of the infringing products.

This preliminary injunction can be sought against small, medium or large retailers and distributors, and has the following advantages:

- proof of the infringement is obtained; and
- infringers are obliged to declare who they obtained the infringing products from, and disclose evidence such as sales invoices, origin of the products, and any other evidence in writing disclosing the source of the products.

If a settlement with the infringer is not reached within 15 working days after the preliminary injunction is executed, a civil or criminal court action must be filed.

iii. Compulsory Pre-trial Mediation Process

Mediation is an informal and very flexible procedure aimed at encouraging parties to seek the fulfillment of their interests.

In this process, parties are invited to an informal meeting to discuss the possibility of reaching a settlement. The parties and their respective attorneys are brought together by the mediator, who, as a neutral party, endeavors to lead them to a mutually acceptable and voluntary agreement.

The procedure is conducted through hearings where the parties' concerns are raised, as well as at separate private hearings, if the mediator considers this necessary to improve the parties' positions. The law fixes a 60-day period to complete the whole process. This period may only be extended on request of the parties.

When a settlement is reached, a written agreement must be signed by both parties, their attorneys and the mediator. If the parties fail to reach an agreement, the party who requested the mediation is in a position to initiate an action to enforce its rights in a federal criminal court.

Generally, mediation hearings have a positive outcome in small trademark infringement matters, as most infringers are intimidated by the process and are willing to negotiate. The Procedural Code of the city of Buenos Aires establishes that a mediation hearing is mandatory before initiating a lawsuit in court. Criminal actions do not require a prior mediation hearing.

iv. Provisional Measures

Article 50 of the GATT/TRIPS agreement establishes that judicial authorities have the authority to order prompt and effective provisional measures, to prevent an infringement of any IP rights.

On the basis of this article, the courts have issued injunctive relief in the form of an order compelling a plaintiff to suspend the manufacture and/or sale of infringing products during the three to four years the trademark infringement court action takes place.

In this case, from the date the provisional measure is executed, and unless a settlement with the infringer is reached, there is a 10-working-day period to file a civil and/or criminal action. At the time of negotiating a settlement, total or partial reimbursement of expenses incurred by the owner of the registered trademark should be negotiated.

v. Civil Court Action –Trademark Cessation of Use Action

The Trademark Law provides for a civil action to obtain the cessation of use of a trademark without the proper consent of its proprietor.

When this action is filed, the plaintiff may demand that the defendant post a bond if he or she does not discontinue the improper use of a trademark.

Only in default of a real security, the plaintiff may request the suspension of the use of the trademark, the attachment of the infringing objects giving sufficient security.

The Federal Courts on Civil and Commercial Matters are competent to try civil actions. The Civil and Commercial Procedural Code, which rules ordinary actions, is applicable in this case.

vi. Denouncement before a Criminal Court

In Argentina, any party that has reason to believe the existence of a criminal offense may file a denouncement with a criminal court. In this case, a Federal Criminal Court rules, and enforces a range of precautionary measures, including attachment or embargo of the infringing products. During this stage of the proceeding, the trademark registration owner acts jointly with the district attorney.

After the infringed products are seized during the execution of a raid, the action is steered by the district attorney, and the denouncing party does not participate in the investigations and proceedings. However, a party who has been directly prejudiced as a victim of a criminal offense may also file a criminal action with the Federal Criminal Courts and act as the main accuser, together with the district attorney.

In a criminal denouncement, the trademark registration owner is not considered a party to the case. Thus, he or she will not have the right to intervene in the investigation or at any stage of the process afterwards during the Court proceedings.

vii. Registration of Trademarks before Customs

In Argentina, trademarks can be registered with the Customs Office in a formal registration system called the Alert Registration System (ARS) (*Sistema de Asientos de Alerta*), which, pursuant to Law No. 25.986, enables the Customs Office to stop infringing products.

Once customs detects the entry of imports that match the goods covered by the trademarks registered in the ARS system and that the importer is not one of the representatives, the importation proceeding is blocked for three days, and the Trademark Fraud Division is informed via ARS, as is the trademark owner.

The owners of the registered trademarks and copyrights will be notified to attend (whether personally or through their legal representatives) the customs verification procedure within three days. Should the IP rights owner not attend the verification procedure, and if necessary, customs may act on its own initiative by notifying the Federal Criminal Courts of the “supposedly” infringed goods.

If the inspected goods are suspected to be illegitimate products (counterfeit), the owner of the registered trademark or copyright is entitled to initiate the corresponding administrative or judicial action.

L. Brazil

1. Online Infringement and Counterfeiting Trends

In spite of combined efforts by public authorities and IPR owners to search and take down webpages containing and/or offering counterfeit products, it is still usual to find counterfeit goods being offered for sale on auction sites, and in blogs and profiles in social networks such as Facebook, Twitter and Instagram.

In the case of counterfeit products, the terms of use applied by the majority of auction sites and individual sales platforms, and by some social networks, already prevent the violation of IP rights by the users placing the advertizing or content. Nevertheless, it should be noted that the auction site/sale site/social network, in principle, will not be deemed liable for failing to remove the infringing content without a specific court order (please see the section on the Brazilian internet legal framework below).

The online sale and advertisement of unauthorized (i.e., gray) products informally imported by individuals is even more common than the sale of counterfeit products. Many individuals attempt to evade customs’ surveillance and import gray goods into the national market, for the sole purpose of reselling and/or advertizing such products in blogs, on social networks or in profiles on auction sites.

However, in practice, preventing the sale of products originating from parallel importing can be difficult. In fact, if the products have been legally acquired by the individual (abroad or in the

Brazilian territory), the user will be protected by the principle of exhaustion of rights (one's right to resell his or her used legitimate goods, regardless of the consent of the IPR holder).

In view of this, trademarks and logos are widely used for the purpose of advertizing products, and, if the product itself is not counterfeited, the chances of successfully taking down the ad or content through a court order request are low.

2. Enforcement Strategies

a. Laws Specific to Online Counterfeiting/ISP Liability

There is no specific law in Brazil regarding online counterfeiting and, in principle, Brazilian general rules regarding IP enforcement apply.

However, considering the particularities of the online environment, there are other rules and strategies that relate to, and can be used in the event of, IP infringement.

i. Internet Legal Framework

The Brazilian Internet Legal Framework (Federal Law No. 12,965/14) (Marco Civil) sets forth the general principles governing the interpretation and creation of other laws and regulations in connection with the internet and online relationships in Brazil.

Among other matters, Marco Civil addresses liability for user-generated content, stating that the ISP will not be liable for damages arising out of third-party generated content (which includes the information and content featuring in users' profiles such as on Twitter and Instagram), unless it fails to take down the content after a specific court order containing clear and specific instructions to identify and remove such infringing content. Considering that auction sites and other social networks are characterized as ISPs for the purposes of Marco Civil, in principle such ISPs are not required to remove infringing content until the party harmed by such content obtains a specific court order.

However, this provision does not apply to violations of copyrights or related rights, which shall be subject to specific legal provisions. While the terms and conditions for the removal of online generated content infringing a third party's copyright are still subject to discussion, if the IPR owner is able to give evidence that the user's content violates the copyright, there may be grounds to request the immediate removal of copyright-infringing content.

Additionally, Marco Civil provides for a series of obligations on ISPs concerning the collection of users' access and connection logs, which, pursuant to a criminal or civil investigation, can be useful to ascertain the identity of the infringing user in the event of court or out-of-court measures (see "Obstacles to Enforcement" below).

ii. Analysis of Terms of Use Applicable to Each Online Vendor

As mentioned above, most of the terms of use applied by the majority of auction sites and individual sales platforms, as well as the terms and conditions of some social networks, include express provisions to prevent their users from placing ads or content violating a third party's IPRs.

In certain cases, the terms of use may provide for specific dispute resolution mechanisms or reporting tools to remove or cancel accounts or ads that the platform understands infringes a third party's rights and the terms and conditions of use applicable to the platform.

In view of this, in the event of online infringement through a third-party platform, the terms and conditions of such third-party platform should be thoroughly analyzed to confirm whether there are any possible private measures for taking down the infringing content.

Nevertheless, and subject to our above comments concerning ISP liability under Marco Civil, it should be noted that the auction site/sale site/social network, in principle, will not be deemed liable for failing to remove the content without a specific court order.

b. Other Enforcement Strategies (Out-of-court Proceedings)

i. Cease and desist letters

In our experience, the delivery of a cease and desist letter informing the infringer of the violation of IPRs is usually effective in successfully obtaining the removal of the infringing content, especially in the case of small individual infringers. However, in the case of gray products (when the user is protected by the principle of exhaustion of rights), the terms of the cease and desist letter must be drafted carefully, in order to amicably argue for the removal of the content and avoid accusing the user regarding the sale of products that is, in principle, legal under Brazilian laws.

ii. Domain Name Dispute Resolution

If the infringement refers to the unauthorized use of trademarks in the composition of domain names, the IPR holder can use a specific procedure for dispute resolution concerning domain names, the Brazilian Administrative System for Internet Disputes Related to Domain Names (SACI-Adm), implemented by NIC.br (the Brazilian entity responsible for domain name registration). The party claiming the infringement is required to give evidence of ownership of a registered trademark before the Brazilian Patent and Trademark Office (PTO) or of a registered domain name that conflicts with the third party's registered domain name. It must be noted, however, that only domain names registered after 1 October 2010 (after the date of the creation of the SACI-Adm system) are required to be subject to these proceedings.

c. Standards for Infringement

There are no specific standards for infringement applicable to the online environment.

d. Obstacles to Enforcement

The control of infringing products being advertized or sold in the online environment can be a tough defense activity, which depends on constant patrolling and investigation. However, once the infringing webpage is identified, NIC.br's domain name registration database may contain data and contact information concerning the person or entity responsible for the operation of a certain ".br" website, which, in many cases, may suffice to identify and contact the infringer regarding court or non-court measures.

In the case of infringement by an anonymous user (or a user with a non-identifiable nickname), Marco Civil provides for a minimum term for ISPs to keep records of users' access to a specific application (six months) and connection logs (one year). These terms may be subject to extension if required for a civil or criminal investigation. Subject to a court order, these recorded logs can be used to try to ascertain the identity of an anonymous user, through crossing the data related to the internet protocol used to access a certain website within a certain date and time, which may allow the identification of the user responsible for the infringement.

M. Colombia

1. Introduction

Luxury and fashion products and brands normally have worldwide recognition. The infringement of the rights and counterfeiting of goods of the luxury and fashion industry is a very profitable business for pirates and free-riding competitors, and in Colombia there are legal means to ensure proper protection of those rights.

The local IP legislation does not give any special protection to luxury and fashion products and brands. Nevertheless, the rights applying to those products may be protected by trademark and industrial designs registrations and copyrights.

With the constant evolution of technologies, the infringement of the IP rights of luxury and fashion brands is also taking place in the online landscape. While Colombian law has not evolved with the same speed as technology, and there is not a special regulation for the enforcement of those rights online, they may be enforced by the general liability laws.

2. Protection for Luxury and Fashion Products

During the last decade, several luxury and fashion brands have entered the Colombian market. Securing adequate IP protection is very important to ensure an appropriate enforcement of rights. While there is no local legislation that specifically protects the luxury and fashion brands and products, the general IP laws are sufficient to protect those rights.

Under local law, the signs used by the luxury and fashion industry, and the products themselves, may be subject to IP protection by means of trademark and industrial design registration or by the deposit of copyrights.

Distinctive signs used to identify products or services may be protected through trademark registrations. This registration is regulated by Andean Community Decision 486/2000, and it is granted over 10 renewable years. The three main prerequisites to register a trademark are that the sign is perceptible, that it is capable of graphic representation and that it is sufficiently distinctive. Some luxury and fashion products (e.g., perfume bottles) may be also protected as three-dimensional trademarks. As a regular trademark, three-dimensional trademarks must comply with the requisites of the Andean norm to obtain registration. In this case, the distinctiveness of the three-dimensional mark is very important, as there are several applications of three-dimensional trademarks that are considered to be the usual form of a product.

Luxury and fashion products may be also protected by means of registration of industrial designs, to protect the external appearance of the product. The registration of the industrial design is also regulated by Andean Community Decision 486/2000. The main prerequisite to obtain the registration of an industrial design is its novelty, and the right is granted for 10 years.

Finally, an additional method to protect the products of the fashion and luxury business is by means of works of applied art. In Colombia, works of applied art and copyrights are protected by Law 23/82 and Andean Community Decision 351/1983. The main prerequisite to obtain copyright protection is the originality of the work. In the case of works of applied art, it is necessary that the work is a real artistic creation, which may be separated from the industrial application of the product. Therefore, it is important that the product to be protected is an original and artistic work, and not the usual presentation of the product.

3. Enforcement of Rights

The local legislation does not differentiate the enforcement of rights in the online and offline landscapes. Therefore, the enforcement of rights relevant to the luxury and fashion industry is through the general liability laws relating to IP infringement and counterfeit.

Combating online infringement and counterfeiting is very challenging and the enforcement of rights is difficult for different reasons. To initiate any action, it is necessary to demonstrate that the online content is directed to Colombia and that there is a right that is being infringed. In the case of websites, e-commerce platforms and social networks, it is not always easy to demonstrate that, in fact, the content is directed to Colombia. In addition, when the owners of the domain names where the infringement occurs or the ISPs are not domiciled in Colombia, there are jurisdictional issues involved in obliging them to be part of the processes and for judicial decisions to be binding on them. Therefore, to enforce rights against infringers that are not domiciled in Colombia, an alternative in the case of social networks and e-commerce platforms is to use their complaint systems, which normally have notification and counter-notification procedures.

There are currently no specific laws regarding ISPs. Law 1341 of 2009 defines the principles relating to the information and communication technologies, and states that ISPs are ruled by the norms of private law, including the Civil Code and, as such, by the liability regulations. Therefore, under the general liability regulations, ISPs may have an extra-contractual civil liability. In this case, it is necessary to demonstrate the existence of damage (actual damages and loss of profit).

Colombia recently executed a free trade agreement with the U.S., which has provisions regarding ISPs, under which they must cooperate with copyright owners in deterring the unauthorized storage and transmission of copyrighted materials. In addition, the agreement provides a limitation of liability, for copyright infringements that ISPs do not control, initiate or direct, and that take place through systems or networks controlled or operated by them or on their behalf. However, please note that the bill that regulated this provision was declared unconstitutional and, therefore, it will be issued again.

In the case of domain name disputes with local registrars, the dispute must be resolved according to the Uniform Domain-Name Dispute-Resolution Policy.

In view of the above, it is important to note the local legislation enforcing the rights relevant to the luxury and fashion industry, which is as follows:

- Andean Decision 486/2000: this is the main law on industrial property in Colombia and the Andean pact countries (Bolivia, Ecuador and Peru). It regulates the proceedings for the registration and protection of industrial property rights. It is the basis for the owners of industrial property rights to initiate infringement and criminal actions, and border measures.

- Andean Decision 351/1983 and Law 23/1982: These are the basis for the protection of copyrights in Colombia, and entitle the owners of copyrighted work to initiate infringement and criminal actions against infringers and counterfeiters.

N. Australia

1. Online Infringement and Counterfeiting Trends

a. Key Sources of Infringement

There has been a rapid increase in online retail trade in Australia, and, given exchange rate fluctuations, Australian consumers are increasingly looking to purchase goods from offshore online retailers.

The increased popularity of online shopping includes "stand-alone" e-commerce sites, selling branded products at competitive prices and often at prices that are "too good to be true".

Similarly, sites that offer deals on branded products for limited times are also on the rise (for instance, buyinvite.com.au and catchoftheday.com.au). Auction sites such as eBay and Gumtree remain popular, alongside social networking services, such as Facebook, which permit retail trade.

It is not uncommon for stand-alone, auction and deal sites to be sources of counterfeit goods, often deceiving consumers seeking to purchase genuine products.

b. Evolving Nature of Online Counterfeiting and Infringement

There is an ever-increasing sophistication to online counterfeiting activity. Counterfeit traders monitor customs notice recordals (to identify existing and emerging brands where border protection measures have not been put in place), use Google and search engine optimization to boost rankings, adopt domain names and design websites that avoid the use of core brand names and registered trademarks (so as to seek to avoid liability for trademark infringement or straightforward domain name enforcement proceedings).

2. Enforcement Strategies

a. Laws Specific to Online Counterfeiting/ISP Liability

In general terms, online counterfeiting activities are subject to the same Australian laws that are applicable in an offline environment. In addition to conduct in relation to physical counterfeit products, online counterfeiters may engage in further acts of infringement as a result of the depiction of trademarks, artistic works and/or products on a website.

In the context of copyright infringement, the courts have enhanced powers to grant relief to copyright owners in civil actions involving large-scale commercial online infringement. The court may take into account likely infringements, as well as proven infringements, in considering whether infringement is on a "commercial scale" and formulating appropriate relief.

ISPs, as a general rule, are not liable for what their subscribers do with the services provided to them unless they are found to have positively authorized the infringing conduct. In addition, there are safe harbor provisions in the Copyright Act 1968 (Cth), which limit the remedies against a carriage service provider (including an ISP) that satisfies certain conditions in the legislation.

Where these conditions are satisfied, the ISP will not be liable for damages or an account of profits or any other monetary relief. Instead, the relief against an ISP is limited to orders that may require the ISP to take reasonable steps to disable access to an online location outside Australia, terminate a specified account, or remove or disable access to infringing copyright material.

b. Other Enforcement Strategies

The main enforcement strategies used against online counterfeiters include the following:

- periodic patrolling and targeted campaigns against online counterfeiting activity;
- cease and desist letters;
- domain name dispute proceedings (UDRP, auDRP);
- customs seizures;
- collaboration with search engines and auction sites; and
- the International Anti-Counterfeiting Coalition (IACC) payment processor initiative.

c. Standards for Infringement

The same standards that apply to the offline landscape apply to the online landscape.

d. Obstacles to Enforcement

The key obstacle to enforcement action in the online landscape remains the identification of infringers. Infringers often submit false identification details to domain name registers and auction sites, and we have seen an increase in the use of domain name registration service providers such that the identity of website operators is not available using usual searches and remains elusive. Domain name and corporate searches often yield limited results, particularly if the perpetrators are overseas. This gives rise to significant challenges in deploying cease and desist letters, and service of legal proceedings. These challenges also apply in the context of the identification and seizure of an infringer’s assets.

In addition to these challenges, online retailers are commonly offshore sites selling into the Australian market, which gives rise to additional jurisdictional hurdles.

As a result of a strong Australian currency and Australian government policy settings, parallel importation is now part of mainstream trade, and mixed or alternating shipments of parallel and counterfeit goods are difficult to detect.

O. China

In the digital world, infringement can take a variety of forms. In China, online infringement is primarily conducted via (a) stand-alone websites, (b) trading platforms and (c) social media. When enforcing trademark rights against online infringement, a primary option for a foreign brand owner would be to discover the offline identity of the infringer, so that administrative and judicial actions can be initiated. Obtaining information about the source of infringement, however, has become more and more difficult in recent years, as online infringers have become more sophisticated in their operations. As an alternative, brand owners can seek online enforcement options. Although these options may not be effective against experienced and repeat infringers, they still play an important role in stopping the online sale of counterfeits.

1. Infringement on Stand-Alone Websites

a. Domain Name Infringement

A stand-alone website may infringe on a brand owner's trademark rights by having a domain name identical or similar to the brand owner's trademark. In the best-case scenario, the infringing domain name leads to an inactive website or redirects to another website with content unrelated to the brand owner's business. In the worst-case scenario, the infringing domain name leads to a website that imitates the brand owner's official website and sells counterfeits.

In dealing with domain name infringement, brand owners often rely on dispute resolute policies, with different policies available for different domain names. ICANN's UDRP is available for top-level domain names such as ".com" and ".net". China has a similar policy, the China Internet Network Information Center (CNNIC) Domain Name Dispute Resolution Policy, which is available for the country-code domain name ".cn" and Chinese domain names such as ".中国" and ".公司". While the CNNIC policy largely mirrors the UDRP, it has a special two-year limitation. In other words, in order to challenge a domain name under the CNNIC policy, the dispute resolution proceeding must be initiated within two years from the domain name registration date. After the two-year window closes, the brand owner's only recourse to challenge the registration of the domain name is through civil litigation.

During the next few years, the launch of new gTLDs will create more than 1,000 new domain name extensions, including generic terms (e.g., ".luxury"), brand names, geographic areas and communities. The addition of these new domain name extensions raises new challenges for brand owners in safeguarding their trademarks against online pirates. Registering their trademarks with the Trademark Clearinghouse would allow brand owners to take advantage of ICANN's sunrise period. Registration would also allow brand owners to be notified of domain name registrations that are identical to their trademarks. Brand owners may then rely on the URS to suspend the infringing domain name.

b. Sale of Counterfeits

Besides domain name infringement, infringers may also sell counterfeits on stand-alone websites. If an infringer's offline identity is discovered, a brand owner can resort to offline enforcement options, such as sending a cease and desist notice to the infringer, filing a complaint with the local administrative agency, or even commencing a civil action. Even if the infringer's offline identity cannot be discovered, a brand owner can still resort to online enforcement actions against the website.

All websites whose servers are located within China are required to obtain an internet content provider (ICP) license from the local telecommunications regulator. If illegal activities are conducted through a website, the website's ICP license can be revoked by the local telecommunications regulator. Without the ICP license, all traffic to the website will be blocked.

The primary hurdle for a brand owner in getting an infringing website's ICP license revoked is that local telecommunications regulators do not accept complaints filed by private parties. A private party such as a brand owner would have to file a trademark infringement complaint with the local Administration for Industry and Commerce (AIC). And if AIC is convinced that the website is selling counterfeits, it may request assistance from the local telecommunications regulators to revoke the website's ICP license and block access to the website.

Revocation of an ICP license is not an effective way of dealing with websites whose domain names are held through a foreign registrar or whose servers are located outside of China. Although technically feasible, the Chinese government will only block an overseas website if the website has created substantial harm to public safety or social order in China. This standard is very high and extremely difficult for brand owners to meet in trademark infringement cases.

An infringing website can be closed by the network service provider. Under China's tort law, a network service provider is jointly liable with an infringer if the service provider fails to take reasonable action against an infringement when it knows or should have known about the infringement or receives notice of the infringement from the brand owner. In practice, network service providers will take action only if the infringing activities are obvious and straightforward. Brand owners have difficultly in pressuring a service provider to close an infringing website if the service provider decides not to cooperate. Furthermore, this option may produce short-lived results, as experienced and repeat infringers can easily reopen the website with a different network service provider and resume the infringing activities.

Another online activity that causes concern for brand owners is "purchase by agent" (*dai gou*). Purchase by agent is similar to parallel importing in that genuine products are resold to consumers without the brand owner's authorization. Vendors use the internet to locate potential consumers in China and arrange for local agents to make purchases in foreign countries or regions where products are sold at a lower price. While counterfeits can be dealt with on the basis of trademark infringement, purchase by agent is more difficult to stop because it involves genuine products.

2. Infringement through Trading Platforms

Purchasing from trading platforms has become mainstream for online shoppers in China. In the past two years, both the number of sales and the scale of transactions through trading platforms have grown exponentially. In China, the major online trading platforms are Taobao and Tmall, both of which are owned by the Alibaba Group. Competing trading platforms include JD.com and Amazon.cn.

Taobao is the largest consumer-oriented online trading platform in China. Because natural persons are not allowed to sell goods on stand-alone websites, individual vendors rely heavily on trading platforms such as Taobao. Although Taobao has taken steps to protect IP rights since being listed as a "notorious market" for pirated and counterfeited goods by the Office of the United States Trade Representative, it remains a favourite forum for infringers to sell counterfeits.

Taobao has an online IP protection system, through which brand owners can file take-down notices against listings of infringing products. If the Taobao administrator handling the take-down notice is satisfied that the listing refers to counterfeits, then Taobao will remove the listing and punish the vendor by reducing its compliance credit. If the vendor has a history of selling counterfeits, Taobao may even examine and remove listings that weren't identified in the brand owner's take-down notice. Unfortunately, this added enforcement mechanism has not been uniformly adopted by Taobao administrators.

In general, Taobao conducts strict reviews of take-down notices. Brand owners need to make a *prima facie* case showing that the listing refers to counterfeits. Sample purchases are often needed to support this. When an infringer maintains multiple listings, brand owners may need to produce separate evidence for each listing. If Taobao refuses to act on the take-down notice, the brand owner generally has no feasible way to challenge its decision.

Even if Taobao removes a listing, it will not disclose the offline identity of the vendor who posted it. Brand owners often need to conduct private investigations to uncover the source of the infringement, in order to take further enforcement actions.

3. Infringement via Social Media

Social media use has a high penetration rate in China, especially among the younger generation. The most popular social media platforms are Weibo (a microblogging service operated by Sina) and WeChat (an instant messaging service operated by Tencent). Although social media platforms are not trading platforms by nature, more and more infringers are taking advantage of social media platforms to locate potential consumers and sell counterfeits.

Preventing infringement on social media is often difficult. First, brand owners are less likely to be aware of ongoing infringement on it because: (i) most social media platforms do not contain search features that enable brand owners to monitor for infringement; and (ii) social media platforms allow infringers to communicate privately with consumers. Second, even if a brand owner becomes aware of an infringement, convincing social media platforms to take action against small individual instances of infringement is difficult. The social media platform often feels no incentive to act, since it is not a trading platform by nature and is therefore less likely to be held jointly liable for any infringement via it. Third, brand owners often cannot pursue conventional offline enforcement options against those who infringe using social media because these infringers are often adept at covering their tracks and concealing their offline identities.

P. Hong Kong

In this era of digitalisation, online infringement is one of the biggest challenges facing rights holders. Product counterfeiting represents a fraud on local consumers and damages the operations of legitimate businesses. It is therefore crucial for brand owners to develop strategies and put in place programs to enforce their rights, particularly in the online landscape.

In Hong Kong, online infringements typically take place through channels like (i) stand-alone websites; (ii) online auction platforms/e-commerce platforms; and (iii) social media.

1. Stand-alone Websites

A stand-alone website may infringe IP rights in two ways – (i) selling counterfeits directly to buyers; or (ii) using a domain name that is identical or similar to a registered trademark, in addition to the sale of counterfeits.

Prior to commencing any action, best practice is to make background inquiries or conduct investigations to obtain information on the identity of the website’s operators and the details of its operation.

A stand-alone website that commits the sale of counterfeits can be stopped by a cease and desist letter (C&D letter) sent to the infringer, requesting cessation of the sale of counterfeits, delivery up of stock and payment of compensation. If, however, the operator of the site fails to comply with the C&D letter or any other subsequent settlement demands, possible civil actions can be taken.

In addition, the rights holders may consider filing a complaint with the ISP hosting the site, urging it to take down the infringing website. In practice, ISPs are prepared to cooperate with rights holders and exercise their discretion to close down infringing sites to avoid potential civil liability for infringing sales. Presently, there is no regime of statutory liability for ISPs in relation to infringements committed by websites hosted by them, although potentially they may be liable for the secondary infringement of aiding, abetting, counseling or procuring the infringements on these networks.

In cases that involve the use of a domain name that is identical or similar to a registered trademark, it is advisable to include as part of the demands a voluntary transfer of the domain name ownership to the rights holder. The majority of cases are settled without the need for formal litigation action, as individuals and entities in Hong Kong are normally responsive to receipt of C&D letters.

In the event that negotiations are unsuccessful, in order to recover the ownership rights of the domain name, the rights holder may file a complaint under the UDRP to the relevant domain name dispute resolution services provider, based on the type of domain name at issue: e.g., Hong Kong International Arbitration Centre (HKIAC) or the China International Economic and Trade Arbitration Commission (CIETAC).

When filing a complaint, the rights holder must prove all of the following elements:

- the domain name in dispute is identical with or confusingly similar to a trademark registered in Hong Kong, to which the rights holder has ownership rights;
- the infringing party has no rights to or legitimate interests in that domain name; and
- the domain name in dispute has been registered and is being used in bad faith.

For clear-cut domain infringement cases, a more cost-effective and expeditious remedy is available under the URS. Rights holders may lodge a complaint to a URS provider, e.g., ADNDRC. If the complaint is deemed to be in compliance with the filing requirements after an initial administrative review, the website at issue will be suspended within 24 hours of notification of the complaint, and if the complaint succeeds afterwards, the suspension will remain in effect for the rest of the registration period of the domain name.

2. Online Auction Platforms/E-commerce Platforms

In Hong Kong, the most active and popular local online auction platforms are Yahoo! HK and eBay. In addition, local consumers are increasingly accustomed to shopping on Mainland China's e-commerce platforms, like Taobao and Tmall, a phenomenon that complicates rights holders' enforcement strategies and cross-border enforcement actions.

Rights holders would generally file complaints with the platform operators, urging them to take down the infringers' listings, and, at the same time, target the more serious infringers with investigations to gather evidence for the purpose of potential civil litigation, or referral to the

Hong Kong enforcement authorities, i.e., the Hong Kong Customs and Excise Department (Hong Kong Customs) for criminal investigations.

Most of the platforms have developed their own complaint systems for rights holders to report infringement cases. Upon the submission of an infringement report that provides details of the listing, the involved IP rights, and the scope of the infringement, these platforms will take down the infringing listing and stop the sale of the counterfeits. Yahoo! HK and eBay have also implemented an "E-auctioning with Integrity" scheme, in collaboration with Hong Kong Customs, to strengthen the screening mechanism of goods and expedite the take-down process with a simplified complaint procedure. Sellers with a history of multiple violations will be suspended under the scheme.

3. Social Media

Recently, there has been a tendency for infringement activities to move from traditional online auction platforms to social media sites. Hong Kong Customs has detected an increasing number of reported cases involving the use of social media to advertize and promote infringing goods in recent years. Enforcement in these type of cases poses more challenges because of the difficulty of identifying the infringers who conduct business behind anonymous social media accounts.

Rights holders are advised to adopt a similar enforcement approach to infringements via social media sites as that for e-commerce infringements. The primary approach would be to file a take-down notice to remove the infringing content from the infringer's site on the social media platform, coupled with the issuance of a C&D letter and subsequent negotiations to encourage compliance and settlement. In most cases, a C&D letter can only be sent by email, since the physical addresses or locations of infringers are not readily available.

Further, the take-down mechanisms of social media platforms are generally not as advanced as those of the e-commerce platforms. Rights holders and their agents may find it necessary to actively follow up pushing the operators to take action.

Q. Japan

1. Online Infringement and Counterfeiting Trends

a. Key Sources of Infringement

In Japan, the main sources of counterfeits online have long been, and still are, auction sites and e-commerce platforms, such as online shopping malls. According to a recent report, in a survey conducted by the Japan Patent Office (JPO) in 2012, approximately 60 percent of companies faced IP right infringement on the internet, and the number has been increasing since JPO's first survey, in 2008. Types of infringement frequently seen among online include (i) sales of counterfeits in the domestic online shopping sites; (ii) unauthorized use of trademark and/or service marks; (iii) sales of counterfeits on foreign online shopping sites; (iv) illegal copying of contents or designs publicized on the internet; and (v) trade of counterfeits in domestic auction sites and foreign auction sites.

Infringing activities on social networking services or instant messaging services are not very common in Japan to date. However, considering that recently one of the most popular instant messaging services in Japan had a number of instances of being used by criminals trying to commit fraud, criminal groups may increasingly conduct IP-infringing activities through such services.

b. Evolving Nature of Online Counterfeiting and Infringement

JPO's report identifies trademark rights as the most frequently infringed IP rights on the internet.

The increased sophistication of counterfeiters can be seen in their manufacturing processes. Counterfeiters often (i) divide the processes of manufacturing, wrapping, and applying logo stickers between several different places, and do not combine them immediately before sales; (ii) misappropriate only another person's design, not their trademark; (iii) sell infringing copy at a price that is just as high as that of a genuine product; (iv) do not physically place infringing trademarks on the products that can digitally display those trademarks, to make it more difficult for law enforcement to find the infringement; (v) file an application for registration of another person's trademark before the person who has a legitimate interest in the trademark files an application, to make it difficult for law enforcement to accuse the counterfeiters; or (vi) after taking down a website pursuant to demands by an IP rights holder, revert to the online counterfeiting activities by establishing a new website.

2. Enforcement Strategies

a. Specific Law or General Liability

ISPs, including e-commerce platform providers, have been found liable under laws generally applicable to any person (as opposed to laws that apply only to ISPs) for IP rights infringement that was conducted by a third party through the service that the ISP provides.

For example, the IP High Court has held that an operator of an internet shopping mall can be liable for trademark infringement if a retailer sells a product infringing on trademark rights through the online mall (*Chupa Chups* case, IP High Court Heisei 22 (Ne) No. 10076). Although the IP High Court concluded the defendant in this case was not liable, its ruling, together with the statutory law providing limitation of ISPs' liability (the Providers Liability Limitation Act (PLLA)), provides for a scheme whereby ISPs can defend themselves against claims of liability for its customers' infringing activities. For example, an online shopping mall operator's removal of infringing contents within a reasonable period after the IP rights holder's notice can be a reason to find the ISP not liable. Pursuant to this ruling, brand holders can demand ISPs take steps to stop online infringement by their customers, by threatening that failure to take such measures would leave the ISP liable for the customers' infringement.

b. Other Enforcement Strategies

As stated in JPO's report, it is often effective to have external legal counsel send cease and desist letter. The IP High Court's ruling in the *Chupa Chups* case, together with the PLLA, confirmed that an ISP can be liable if it fails to take necessary steps to stop infringing activities, typically upon notice and take down. Such letters from brand holders to ISPs need to specify the infringing activity. If the ISP does not respond to the request reasonably, the brand holder can file a lawsuit against it for injunctive and monetary relief.

In cases where a Japanese domain name dispute is involved, the JP Domain Name Dispute Resolution Policy (JP-DRP), a dispute resolution policy modeled after the UDRP, is available.

c. Standards for Infringement

Except for cybersquatting, the standards for trademark infringement online do not differ from other types of infringement: i.e., trademark infringement under the Trademark Act and two types of infringement under the Unfair Competition Prevention Act (UCPA). Those standards can be summarized as follows:

- the mark used is identical or similar to a registered mark and the good or service for which the mark is used is identical or similar to the good or service covered by the registration (the Trademark Act);
- the mark used is identical or similar to a well-known mark and the use of the mark is likely to cause confusion as to the source of the good or service (the UCPA, Att. 2(1), Item 1); and
- the mark used is identical or similar to a famous mark (the UCPA, Att. 2(1), Item 2).

The UCPA provides for protection against cybersquatting. The trademark owner can take action under the UCPA if a domain name is identical or similar to other person's trademark and the registrant has intent to gain unlawful benefit from the registration. If successful, the brand holder can be awarded injunctive relief and/or monetary compensation. The injunctive relief under the UCPA is understood to include cancellation, but not transfer, of the domain name. In addition to the protection by the UCPA, the Japan Intellectual Property Arbitration Center provides arbitration for disputes over domain names registered in Japan. The arbitration is governed by the JP-DRP. Under the JP-DRP, a successful complainant can be awarded transfer of the domain name, but monetary relief is not available.

d. Obstacles to Enforcement

Parallel imports or gray market sales are very often seen in online sales of trademarked goods. Under the Japanese trademark laws, imports of trademarked products cannot be unlawful if the trademark is placed under the authorization of the trademark rights holder and the quality of the product is duly controlled by the trademark rights holder. The act of threatening a parallel importer as if it were infringing a trademark right can constitute violation of the Japanese competition laws. Therefore, the trademark holder must carefully check if the products imported into Japan are genuine goods or not. Another obstacle is identifying the infringer. Although Japanese regulation on e-commerce requires online retailers to present their names and contact information on the sales website, this is often violated by infringers. A practical way to check authenticity of the trademarked products and identity of the infringer is to conduct a test-purchase anonymously. Requesting ISPs, under the PLLA, to disclose the contact information they have is another option.

R. Singapore

1. Online Infringement and Counterfeiting Trends

a. Key Sources of Infringement

Infringement in the online sphere for luxury goods in Singapore occurs mainly in the following areas:

- e-commerce platforms: Alibaba, AliExpress, Taobao, Tmall, Qoo10, StreetDeal.sg;
- social networking services: blog shops and Facebook pages set up by individual sellers; and
- individual websites.

E-commerce platforms like Alibaba and Aliexpress are often the source of the infringing products, which local sellers then sell either through local e-commerce sites like streetdeal.sg or Qoo10 or through their own websites or social media pages.

b. Evolving Nature of Online Counterfeiting and Infringement

Online infringers of luxury goods may be broadly classified into the following categories:

- those who do not claim their products are authentic and therefore sell the products cheaply; and
- those who claim their products are authentic but are offering them at a discount.

Counterfeit items are still regularly described by keywords that will be picked up by search filters. For example, goods may be marketed as “BRAND-like’ or “inspired by BRAND”. This would be relevant to all sources of online infringement, as e-commerce platforms and blog shops will feature equally in a general internet search. Sellers of such goods generally do not claim that their products are authentic and will normally price their goods more cheaply to target the mass market. Such listings are more easily picked up by price filters, as the marketed price would generally be much cheaper than that of the genuine products.

Conversely, there are infringers who may price their goods only slightly cheaper than authentic goods and justify the discount by claiming that their goods are bought directly from stores in Europe or America. Such infringers may claim that their goods are authentic and will reassure customers with promises of a refund or a guarantee by a third party, if the goods are found to be counterfeit. Such listings would thus be difficult to pick up via price filters.

Another factor that may influence an infringer’s *modus operandi* is the ease with which the infringer can re-establish an online presence. In this day and age, it is easy to simply change a domain name while retaining the content of the website, thereby making it relatively ineffective even if network/internet service providers (NSPs/ISPs) were to disable access or take down the offending page.

The biggest problem is the proliferation of “micro-sales”; rights owners are seeing many small time-sellers selling small quantities of counterfeit products from a wide variety of brands. These sellers often have very little in stock, which is why they sell products from a variety of brands. It is difficult to justify the cost of any enforcement action being taken against such sellers.

2. Enforcement Strategies

a. Laws Specific to Online Counterfeiting/ISP Liability

There are laws specific to online counterfeiting and NSP/ISP liability in Singapore. New amendments to the Copyright Act (Cap. 63) will soon allow rights owners to obtain injunctions against infringers who flagrantly infringe copyright in their goods, bypassing the preliminary requirement of establishing NSP/ISP liability.

Previously, NSPs/ISPs could enjoy the safe harbor defense, as long as they provided for a take-down procedure, and took "reasonable steps" to disable access to the infringing material. However, if the NSPs/ISPs failed to comply, the rights owners would have to initiate civil proceedings to establish the NSP's/ISP's liability for copyright infringement before the rights owners could obtain an injunction requiring the NSP/ISP to disable access to or remove the infringing material from their network.

b. Other Enforcement Strategies

i. Take-down Strategies

As most e-commerce platforms have their own take-down notice procedures to allow them to take advantage of safe harbor provisions, one possible strategy would be to monitor listings on such e-commerce sites and to issue take-down notices against infringing listings. With improvements in technology, there are an increasing number of service providers that can provide such monitoring services at a relatively low cost.

ii. Criminal Enforcement

For more recalcitrant infringers or infringers known to be distributing large quantities online, investigations can be conducted to identify the physical location where the counterfeit items are being stored. Search warrants can then be obtained and executed against these locations, and the infringer prosecuted for trademark and/or copyright offenses.

iii. Uniform Domain Name Resolution Policy/Uniform Rapid Suspension

Websites found to be using domain names that are similar to various brand names can also be taken down, by commencing UDRP or URS actions to recover these domains from the infringer.

c. Standards for Infringement

The standard of proof in civil acts for trademark infringement, copyright infringement or passing off is based on a balance of probabilities. The standard of proof for criminal offenses under the Trade Marks Act (Cap. 332) or the Copyright Act is that of beyond reasonable doubt.

d. Obstacles to Enforcement

One of the main difficulties in dealing with online counterfeits is the anonymity of the sellers. It will generally require investigative efforts to find out the identity and location of the seller. Sometimes, even when private investigators approach online infringers, they may choose to deal with the private investigators through a proxy or decide not to reveal their real names and contact details.

There is also often difficulty in identifying where the goods are stored. Individual sellers may keep the counterfeit goods in small quantities at different residential locations instead of in a warehouse. Some of the counterfeit goods may only be imported after an order is made, to avoid storage charges. This makes it challenging for rights owners to identify the type and quantity of the counterfeit goods, in order to apply for a search warrant to conduct a raid at the targeted premises.

Online counterfeit goods are also often sold in small quantities. Therefore, rights owners will need to consider the potential return on investment before commencing enforcement actions against any particular online seller of counterfeit goods.

III. Enforcement in the Offline Landscape

As mentioned previously, enforcement in the offline landscape is much more well established in comparison to its online counterpart. Civil and criminal actions are available in every jurisdiction for trademark and copyright infringement, with awards of damages, injunctions and account of profit being the usual civil remedies, and fines and imprisonment being the common criminal sanctions. Most jurisdictions also offer the civil actions of passing off or unfair competition if clear-cut rights cannot be established. Whether the combination of such enforcement tools offers sufficient protection to rights owners in the luxury and fashion industry is debatable, given that fashion designs are not necessarily afforded copyright protection in every jurisdiction, and passing off and unfair competition are difficult to establish.

Civil and criminal actions in some jurisdictions are supplemented by administrative actions and customs recordal and registration systems. Indeed, administrative action remains the key enforcement tool in the world’s largest exporter of counterfeit goods – China, where local administrative authorities will, upon the request of rights owners, conduct raids and impose penalties against counterfeiters. Most custom recordal systems operate in a similar manner. Rights owners will first record or register their rights with customs authorities, who, upon discovering the infringing shipment, will detain the goods, notify the rights owner and ask for verification of the infringement. For jurisdictions without a recordal system, such as Singapore, rights owners bear the burden of notifying customs if they suspect the arrival of an infringing shipment.

Commonly identified obstacles facing rights owners worldwide include cross-border enforcement and identification of infringers. In addition, many jurisdictions pinpoint the lack of deterrent effect of the available remedies and penalties as particularly problematic. This is surprisingly true across jurisdictions with vastly different quantum of damages (e.g., Canada awards approximately US$25,490 in nominal damages for each trademark infringement activity, and China capped statutory damages at US$80,000 until the recent trademark law reform). The issue of intermediary liability is also noteworthy. For example, whether a landlord will be responsible for the infringing activities of tenant on its premises remains contentious in many jurisdictions. While China has specifically legislated for intermediary liability, there is no such authoritative jurisprudence in Japan. France, on the other hand, allows for the cause of action, but the chances of success are low in practice.

A. European Union

1. Civil Action

a. Sources of Liability under Community law

Sources of Liability	***Rights Infringed***
Community Trade Mark Regulation (Council Regulation (EC) No. 207/2009) (CTMR)	Registered Community trade marks
Community Design Regulation (Council Regulation (EC) No. 6/2002) (CDR)	Registered and unregistered community designs

Member States have designated national courts and tribunals of first and second instance in their territories that perform the functions assigned to them by the CTMR in order to adjudicate disputes in connection with the infringement and validity of Community trade marks. These are referred to as the “Community trade mark courts”.[11] Similarly, Member States have also designated “Community design courts”, relevant to the adjudication of Community registered and unregistered designs.[12]

The Community design courts have exclusive jurisdiction in relation to infringement actions, declarations of non-infringement and declarations of invalidity in relation to *unregistered* Community designs, if permitted under the national law of the Member State in question.[13] The capacity of these courts to hear invalidity actions in relation to *registered* designs is limited to circumstances in which such issues are raised by counterclaim or defense in infringement proceedings. Jurisdiction in relation to the validity of *registered* designs is otherwise reserved to the Office for Harmonisation of the Internal Market (Trade Marks and Designs) (OHIM). However jurisdiction in relation to other actions in connection with Community designs, such as ownership or property in those rights, is not the sole preserve of the Community design courts and would be governed by the rules of jurisdiction provided under the Brussels Regulation.[14] Where a rights holder brings an action against an infringer based on their domicile (if permitted), then the court should grant European-wide injunctions, damages and other relief.[15] There are similar rules that apply to Community trade marks.[16]

b. Standards for Infringement

i. Community Trade Marks

Under article 9 of the CTMR, a Community trade mark is infringed when an identical sign is used in the course of trade in respect of identical goods. Infringement will also arise if an identical

[11] Article 95 of Council Regulation No. 207/2009.
[12] Article 80 of Council Regulation (EC) No. 6/2002.
[13] Title IX, article 81 of the CDR.
[14] Council Regulation (EC) No 44/ 2001.
[15] C-235/09 – *DHL v Chronopost*.
[16] Title X of the CTM Regulation.

or similar sign is used with similar or identical goods, and there exists a likelihood of confusion on behalf of the public, or where the use of an identical or similar sign without due cause takes unfair advantage of, or is detrimental to, the distinctive character or the repute of the Community trade mark.

ii. Registered Community Designs

The scope of protection conferred by Community designs encompasses any design for the appearance of the whole or part of a product resulting from the features of the lines, contours, colours, shape, texture and/or materials of the product itself or its ornamentation that does not produce on the informed user a different overall impression from earlier designs. Any such design will only be protected to the extent that it is new and has individual character. Certain aspects of designs are excluded from protection by law, including, e.g., the features of appearance of a product that are dictated solely by its technical function and the features of a design that must be reproduced in an exact form and dimension in order to permit the product in question to be mechanically connected to or placed in, around or against another product so that either may perform its function.[17] A Community design confers the exclusive right to make, offer, put on the market, import or export or use products in which the design is incorporated or applied. Unregistered Community designs confer the right to prevent the acts set out above, but only if the contested use results from an act of copying the protected design.

c. Civil Remedies

As mentioned above, in certain circumstances the court in question can grant pan-European relief, but in others it will be limited to granting relief in the Member State concerned. The Enforcement Directive[18] applies (without prejudice to any national or other Community legislation) to any infringement of IP rights provided under Community law and/or national law in the Member State(s) concerned. At a high level, this obliges Member State courts to ensure that rights holders are able to obtain damages, costs awards, injunctions and publications of judgments in connection with the infringement of IP rights.

European Enforcement Orders (EEOs)[19] are judgments that can be obtained in relation to uncontested civil or commercial claims and can be used to enforce underlying judgments for the payment of money owed. These may be relevant where an infringer has not contested a claim and sums are subsequently owed to the rights holder as a debt. The benefit of EEOs is that they do not require formal recognition by the court of another Member State (which usually takes some time) in order to be enforced there and their recognition cannot be opposed. EEOs will only be relevant in certain limited circumstances; however, they are highlighted here for the sake of completeness.

[17] See Title II of the CDR.
[18] Directive 2004/48/EC.
[19] Under Council Regulation (EC) 805/2004.

2. Criminal Action

The European Police Office[20] (Europol) has an Intellectual Property Crime operation, which assists EU Member States in conducting criminal investigations relating to IP crime in the EU. It assists Member State enforcement operations by facilitating the exchange of intelligence and analysis across Member States. It has no power to arrest suspected criminals and would only be able to assist upon request of the Member State enforcement authorities, if two or more Member States are involved and the evidence indicates that there is an organized criminal network in operation. It is only likely therefore to assist national authorities in relation to large-scale counterfeit operations that stretch across the EU. An example of a recent successful operation is the seizure of nearly 300 internet domain names that were registered across a number of EU jurisdictions and in the U.S. in order to sell counterfeit goods.[21] The seizure of these domain names by governments across multiple jurisdictions was initiated by information fed into Europol and the National Intellectual Property Rights Coordination Center (NIPRCC)[22] by the trademark proprietors concerned.

3. Administrative Action

There are no administrative procedures at an EU level *per se*; however, the European Observatory on Infringements of Intellectual Property Rights[23] is a body comprising experts and specialist stakeholders who seek to influence EU policymaking in connection with IP enforcement. It has no direct enforcement powers, but its members include public and private sector representatives from across the EU.

In addition, *Bureau Européen des Unions de Consommateurs* (BEUC), the European Consumer Organisation, is a representative, non-profit body that acts in the interests of consumers in relation to the implementation of EU policies and highlights safeguards that need to be put in place in relation to European consumers. While it has no administrative powers, it seeks to monitor and issue press releases, with a view to educating consumers in relation to unsafe products and counterfeit activity within the EU.

4. Customs

a. Enforcement Mechanisms

As discussed in other chapters in this book, the EU Customs Regulation No. 608/2013 (the Customs Regulation) enables rights holders to put customs notices, which are formally referred to as applications for action (AFAs), in place on an EU-wide or national basis. Note that EU-wide applications can only be made on the basis of Community IP rights. For example, it is not possible to submit an EU-wide AFA citing a French national trademark as the basis for the application.

There is certain information that must be included in the AFA. This includes:

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[20] Established under Title VI of the EU Treaty, Council Decision of 6 April 2009 (2009/371/JHA).
[21] See https://www.europol.europa.eu/content/292-internet-domain-names-seized-selling-counterfeit-products
[22] The US Government IP enforcement authority.
[23] Established under regulation 386/2012 of the European Parliament and of the Council of 19 April 2012.

- details of authentic goods – photographs of genuine products should also be included, where appropriate;
- technical data on the authentic goods, such as bar codes, security tags and other markers; and
- details of legal and technical contacts.

Once completed, the AFA should be submitted to the relevant local customs authority, if a national application is to be submitted. In the case of an EU-wide AFA, it can be submitted to a customs authority of any of the Member States.

The information contained in the AFA, once granted, is uploaded to a centralized database - the Anti-Counterfeit and Anti-Piracy Information System, COPIS, which, in the case of EU-wide applications, can be accessed by customs authorities across the EU.

The key thing to bear in mind is that the purpose of the information added to the AFA is to enable the relevant customs authorities to recognize counterfeit items. The more helpful a rights holder is when completing an AFA, the better the chance of the relevant customs authority being able to spot potentially infringing goods if they arrive.

The activity levels of customs authorities do tend to vary across the EU, and some customs authorities have more sophisticated processes in place than others, but AFAs are a sensible and proactive means of trying to address the issue of counterfeit goods before they get on to the market.

b. Requirements for Enforcement

The Customs Regulation establishes the so called “simplified procedure” for all EU Member States, whereas previously only 15 Member States had implemented such a procedure. Goods halted by customs can be seized and destroyed if the importer does not contest the detention within 10 working days. Provided the goods are counterfeit, it is common practice to ask the parties involved to give a voluntary declaration of consent to the destruction of the counterfeit goods. It is our experience that, in the vast majority of cases, such an approach leads to a cost-effective result. Only if the importer contests the seizure is action in court necessary. Silence by the importer enables customs to presume consent.

Additionally, the Customs Regulation introduces a “super-simplified procedure” that applies to goods sent in small consignments. This means a maximum of three units or a gross weight of not more than two kilograms. The rights holder may choose to take part in this procedure when filing the customs application. If he or she chooses to do so, the customs authorities inspect the relevant goods without assistance from the rights holder and decide independently on the destruction of the goods if the criteria are met. This means that the rights holder will only be involved in the proceedings if the importer does not consent to the destruction (i.e., actively objects) within the 10-day time frame.

c. Considerations Relevant to the Enforcement Process

Rights holders who experience (or are likely to experience) significant amounts of customs detentions should consider putting in place internal systems to ensure that notifications from customs authorities reach the correct contacts without delay. Customs issue strict deadlines and it is therefore important to ensure that there are no unnecessary delays.

In a similar vein, there should be clear channels in place to enable the relevant technical teams to be able to assess detained goods. Customs should send photographs and/or samples of the seized goods. If they do not, or photographs are not of a sufficient quality, action should be taken quickly to obtain appropriate photographs or samples.

As referred to in the UK section, good relationships with customs can pay dividends. It can be helpful to run training sessions with customs to explain key counterfeit indicators and to meet the individuals who are very much on the "frontline" when it comes to experiencing counterfeit activity. It should also be noted that the Customs Regulation and, by extension, the AFA do not apply to gray market goods.

B. United Kingdom

1. Civil Action

a. Sources of Liability under Statute and Common Law

Sources of Liability	***Rights Infringed***
Trade Marks Act 1994 (TMA)	Registered trademarks
Copyright, Designs, and Patents Act 1988 (CPDA)	Copyright, unregistered designs
Registered Designs Act 1949 (RDA)	Registered designs
Common law of passing off	Unregistered trademarks

The Goods Infringing IP Rights (Customs) Regulations 2004 allows officers of Her Majesty's Revenue and Customs (HMRC) to seize and destroy counterfeit goods.

The Intellectual Property Enterprise Court and the High Court have jurisdiction to hear IP cases.

b. Standards for Infringement

i. Registered Trademarks

Under section 10 of the TMA, a registered trademark is infringed when an identical mark is used in the course of trade in respect of identical goods. Infringement will also arise if an identical sign is used with similar goods, or a similar sign is used with identical goods, and there exists a likelihood of confusion on behalf of the public.

ii. Registered Designs

Section 7 of the RDA provides that a registered design is infringed when a second design is used that does not produce a different overall impression on the informed user (taking into account the degree of freedom of the designer). "Use" includes the making, offering, putting on the market, importing, exporting or using of a product in which the design is incorporated or to which it is applied; or stocking such a product for those purposes.

Note that registered designs are not infringed where an act is done privately and for purposes that are not commercial (section 7A(2)(a) of the RDA). This has implications in relation to 3D printing, as users are permitted to print products that are protected by registered designs if they are printed at home for non-commercial purposes.

iii. Unregistered Designs

Section 226 of the CDPA provides that the owner of a design right in a design has the exclusive right to reproduce (exactly or substantially) the design for commercial purposes by making articles to that design, or by making a design document recording the design for the purpose of enabling such articles to be made.

The unregistered design right is infringed by a person who, without the license of the design rights holder, does, or authorizes another to do, anything that infringes that exclusive right.

Further, section 227 of the CDPA provides that the following acts constitute secondary infringement of the unregistered design right: importing into the UK for commercial purposes; having in possession for commercial purposes; or selling, letting, offering for sale or hire, in the course of a business, an article that is, and that the infringer knows or has reason to believe is, an infringing article.

iv. Copyright

Section 16 of the CDPA provides that the owner of the copyright in a work has the exclusive right to:

- copy the work;
- issue copies of the work to the public;
- rent or lend the work to the public;
- perform, show or play the work in public;
- communicate the work to the public; and
- make an adaptation of the work.

It is an act of primary infringement to do any of those acts, or to authorize another to do so.

Further, section 22-26 of the CDPA set out the acts of secondary infringement, which require the infringer to know or have reason to believe he or she is dealing in an infringing work. These are:

- importing an infringing copy;
- possessing or dealing with an infringing copy;
- providing means for making infringing copies;
- permitting the use of premises for an infringing performance; and
- the provision of apparatus for an infringing performance.

Note, however, that although the standards for protection of copyright are as set out above, works of fashion are not generally protected by copyright in the UK. Copyright is limited to the eight specific works set out at section 1(1) of the CDPA. This includes artistic works, but works of fashion are not generally deemed to be artistic (e.g., cardigans and jumpers have been found not to be artistic works,[24] and, similarly, the stormtrooper helmets used in the *Star Wars* films were not artistic).[25]

This is a particular problem in relation to new 3D printing technology: even though the digital design file may enjoy copyright protection as a literary work, the 3D product itself is unlikely to be considered an artistic work, and therefore will not attract copyright protection.

The surface decoration of a work may be protected. A design that is an artistic work when drawn on paper will be protected if it is used by a designer on a 3D product such as a garment or handbag.

Note that even if a 3D product were considered to be a work protected by copyright in the UK, printing that product at home for non-commercial purposes would likely be exempted from copyright protection come 1 October 2014, under the new proposed private copying exception.

v. Passing Off

To enforce unregistered trademark rights and succeed in an action for passing off, the rights holder must show that:

- it has goodwill or a reputation in the goods or services; and
- there is misrepresentation by the infringer that is likely to lead the public to believe that the infringer's goods or services are those of the rights holder; and
- it has suffered damage caused by that misrepresentation.

vi. Domain Names

As above, to take down or transfer a domain name, a rights holder must demonstrate to Nominet that it i) has rights in a name that is the same as or is identical to the domain name in question; and ii) the registration, in the hands of the respondent, is taking unfair advantage.

c. Civil Remedies

The following remedies are available in respect of trademark infringement, design (registered and unregistered) infringement, copyright infringement and actions for passing off:

- Damages – these are granted on the basis that they should put the aggrieved party back in the position it would have been in had the infringement not occurred. In an action for infringement of copyright, if the defendant did not know, and had no reason to believe, that copyright subsisted in the work to which the action relates, damages are not available. There are no provisions for punitive damages in the UK, although the CDPA does make provision for additional damages to be paid in respect of flagrant infringement.
- Account of profits – this requires the defendant to surrender the profits made.
- Interim injunctions – these can be granted at the court's discretion. The court will consider (a) whether there is a serious question to be tried; (b) whether damages would be an adequate remedy; (c) what the balance of convenience of each of the parties would be should an order be granted; and (d) whether there are any special factors.

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[24] *Guild v Eskandar Ltd* [2001] (38) FSR 645.
[25] *Supreme Court in Lucasfilm v Ainsworth* [2011] UKSC 39.

- Final injunctions.
- Search and seizure orders.
- Delivery up and destruction of goods orders.

d. Obstacles to Enforcement

Please refer to Part I, section 2.4.

2. Criminal Action

Criminal proceedings can be commenced by the rights holder for the following actions:

- trademark infringement;
- copyright infringement; and
- infringement of registered designs.

However, it is more usual to see criminal actions being brought by national authorities such as Trading Standards, which can bring criminal proceedings for breach of the Consumer Protection for Unfair Trading Regulations 2008 (CPRs) (see below).

The TMA and the CDPA create statutory duties on local authorities to enforce the criminal provisions of those acts. Local authorities are also granted enforcement powers in order to carry out those statutory duties: e.g., officers are permitted to seize counterfeit goods and may work with the police to conduct raids.

Section 92 of the TMA provides for the following criminal sanctions for trademark infringement:

- on summary conviction – imprisonment for up to six months, a fine, or both; and
- on conviction on indictment – imprisonment for up to 10 years, a fine, or both.

The provision catches the sale and distributing of counterfeit goods, and the application of labels to goods or packaging, that could be mistaken for a registered trademark. An infringer has a defense if he or she can show that he or she believed or had reasonable grounds to believe that the use of the sign was not an infringement of the trademark. Infringement must be proved beyond all reasonable doubt.

Under sections 107A and 198A of the CDPA, a person is liable if he or she sells, imports into the UK, distributes, or makes an article specifically designed for making copies of a copyright work. A person guilty of this offense is liable for:

- on summary conviction, imprisonment for a term not exceeding three months, or a fine not exceeding £50,000, or both;
- on conviction on indictment, a fine, or imprisonment for a term not exceeding two years, or both.

There is no offense if the rights holder has granted “sufficient consent”.

The Intellectual Property Act 2014 also criminalizes the deliberate copying of a UK or Community registered design. The copying must be intentional and match the registered design exactly or only differ in immaterial details. A person guilty of this offense is liable for a fine, or a prison sentence of up to 10 years, or both.

Although criminal prosecution is less expensive than civil enforcement, recent UK case law has suggested that criminal prosecution should only be pursued in clear cases of counterfeiting.

3. Administrative Action

a. Sources of Liability

The UK government implemented the CPRs, which prohibit unfair commercial practices. In particular, they prohibit:

"*Promoting a product similar to a product made by a particular manufacturer in such a manner as deliberately to mislead the consumer into believing that the product is made by that same manufacturer when it is not.*"

b. Standards for Infringement

The CPRs are enforceable by the following national bodies: Local Authority Trading Standards Services, the Competition and Markets Authority, and the Department of Enterprise, Trade and Investment in Northern Ireland. A breach of the CPRs is enforceable through criminal prosecution, and by civil injunctive action under Part 8 of the Enterprise Act 2002.

As a first step, enforcers will seek to stop infringement by consulting with the trader or accepting undertakings that he or she will not engage in conduct that constitutes infringement. Should the breach continue, enforcers can apply to court for an order to prevent further violations in the UK or EU. Breach of an enforcement order is classified as contempt of court and could result in up to two years' imprisonment, an unlimited fine, or both.

The UK government has recently launched a consultation to consider providing businesses with the power to enforce civil injunctions against parties that engage in infringing conduct under the CPRs. The consultation came about following representations from rights holders that the CPRs were not being regularly enforced against alleged infringers of "copycat products", as it can be difficult for rights holders to do so using existing IP rights.

4. Customs

a. Enforcement Mechanisms

The UK Border Agency (UKBA) has the power to seize goods under Regulation (EU) 608/2013 concerning customs enforcement of IP rights, which came into force on 1 January 2014.[26]

Rights holders may register the following IP rights with customs, using an AFA:

- registered trade marks (including Community trade marks);
- copyright;
- design rights;
- patents; and
- trade names.

The registration of rights enables authorities to look for and detain goods that they suspect infringe IP rights, such as counterfeit goods and gray market goods.

For registered Community IP rights, a single EU application may designate the UK as well as other EU states. However, to register national rights, a rights holder must lodge a UK national

[26] This repealed Council Regulation (EC) No. 1383/2003.

customs application. A UK application has a duration of one year, and this can be extended by a further year.

b. Requirements for Enforcement

When UKBA intercepts the import of suspicious goods, it will notify the declarant or holder of the goods of the seizure within one working day, and give him or her the choice to either: a) consent to abandoning the goods to destruction; or b) object to destruction. Customs will also notify the rights holder of the detention and invite him or her to confirm whether or not he or she believes the goods are infringing, and if so, whether he or she agreed to destruction. All parties have the right to inspect the consignment and the rights holder may request samples.

Goods will be destroyed when the rights holder confirms in writing that the goods infringe an IP right covered by the AFA and the declarant also agrees to the destruction of the goods. customs may assume consent has been given if the rights holder confirms the goods infringe IP rights covered by the AFA and the declarant fails to respond to UKBA within 10 working days.

If the declarant or holder of the goods objects to their destruction, customs will notify the rights holder. If the rights holder does not provide satisfactory evidence to customs that he or she has initiated proceedings to determine whether his or her IP right has been infringed before the end of the detention period, the goods must be released from detention.

Under the so-called “simplified procedure”, legal proceedings may be avoided if the importer consents to destruction, as no further input is required from the rights holders. Similarly, no explicit agreement of the rights holder is required if he or she opts in to the “small consignments procedure”, as goods will be automatically destroyed if the importer agrees to destruction or fails to respond to customs within 10 working days from receiving notification.

c. Considerations Relevant to the Enforcement Process

Customs issues strict deadlines when processing detained goods. As such, there is a risk that alleged counterfeit goods will be released should a deadline be missed, so rights holders must act quickly upon receiving notification of a seizure.

Building a strong relationship with customs officials enhances their awareness of the registered brands and products. Providing customs with examples of new lines and product ranges also ensures that officials have an overall view of the IP rights that are protected.

C. France

1. Civil Action

a. Source of Liability under Statute and Common law Infringement

i. IP Rights Infringement and Unfair Competition/Passing Off

Depending on the IP rights protecting the fashion designs and luxury goods at stake, the IP rights owner can, in accordance with the provisions of the French Intellectual Property Code (IPC), bring a civil action before the competent court of first instance (*Tribunal de Grande Instance*), as courts of first instance have exclusive jurisdiction in IP rights matters, based on:

- copyright infringement;
- design infringement;
- trademark infringement; and/or
- patent infringement.

Generally, IP rights owners also present before courts of first instance additional and alternative unfair competition and passing-off claims, based on articles 1382 and 1383 of the French Civil Code (general civil liability rules) (see below):

- additional claims based on unfair competition/passing off: since IP rights infringement actions and actions based on unfair competition/passing off pursue different purposes, specific wrongful acts that are different from the IP rights infringement acts (e.g., the fact that the infringer has copied several creations of the same designer) must be evidenced for the unfair competition/passing-off claim to be admissible.
- alternative claims based on unfair competition/passing off: on the contrary, presenting an alternative claim based on unfair competition and passing off is advisable, since it can provide an alternative source of protection in case the validity of the claimed IP rights is not recognized or in case the court considers that the IP rights are not infringed.

ii. Unfair Competition/Passing Off

When the relevant fashion designs and luxury goods are not protected by any registered IP right and do not seem to meet the originality requirement necessary for copyright protection under French law, or when the owner of the IP rights does not want the validity of his or her rights to be challenged, the plaintiff may seek protection against slavish imitation or free-riding on the ground of unfair competition and parasitism. In such a case, the plaintiff will bring a civil action before commercial courts (*Tribunaux de Commerce*) based on unfair competition/passing off only.

On the ground of unfair competition, a fashion designer may seek the tort liability of a competitor that slavishly imitates its product, thus causing a likelihood of confusion, or uses other means that are contrary to fair business practices and that may be detrimental to the competitor.

Parasitism can be used as a legal ground against any person, even non-competitors, who profit, without incurring any costs, from the investments and efforts realized by a fashion designer to develop its reputation; its brand universe.

These legal grounds are interesting, since they allow the designer to rely on factors that are exterior to the appearance or design of the product itself: e.g., the packaging of the products, the price, retailing conditions and advertizing strategy.

However, if a plaintiff brings an action before a commercial court based on unfair competition/passing off, he or she will not be entitled to claim any IP rights in support of his or her position. If he or she does so, the commercial court will consider that the case is an IP rights infringement matter, which it has no jurisdiction to hear.

iii. Secondary/Contributory Liability

There is no distinction between direct and indirect liability under French law.

Online Intermediaries

- ISPs

Under the Code of Posts and Telecommunications, ISPs are not responsible for the content of websites to which they grant access unless they are at the origin of the transmission request at issue, or when they select the recipient of the message, or select or modify the content transmitted.

- Online Auction Sites

  Case law on the liability of auction sites has long been inconsistent. This issue mainly depends on the categorization of the online auction sites. Indeed, pursuant to the Law for Confidence in the Network Economy No 2004-575 of 21 June 2004, if the online auction site is considered a host, it could only be liable once it has been informed of the unlawful conduct and has not taken the necessary steps in order to stop this conduct, whereas if it is not considered a host, it could be liable for the infringement perpetrated by its users even prior to receiving this information. The French Supreme Court (FSC) finally settled this question and issued three *eBay/LVMH* decisions on 3 May 2012. FSC applied the ECJ ruling in the *L'Oreal/eBay* case (12 July 2011, C-324-09), according to which the service provider, in order to benefit from article 14 of the Directive 2000/31, must be neutral while providing its services and must not play "an active role allowing it to have knowledge or control of the data stored. The operator plays such a role when it provides assistance which entails, in particular, optimizing the presentation of the offers for sale in question or promoting them".

Other Intermediaries

It may be possible to act against a landlord on the basis of article 1382 of the French Civil Code (general civil liability rules) but the chances of success are low.

Holding infringing products is prohibited under French trademark law. Transporters may be liable when they have knowledge or should have knowledge that they are carrying infringing products.

As regards patent infringement:

- pursuant to article L. 613-4 of the IPC, suppliers of means may be liable for contributory infringements of patents when the supplied means relate to an essential element of the invention, the supply of means has taken place in France and the invention was put into effect in France, and when the supplier has knowledge or should have knowledge that such means are suited or intended for putting the invention into effect; and
- suppliers may also be held directly responsible in relation to infringing products when the product component itself infringes on the IP rights of a third party, or if the raw materials suppliers/original equipment manufacturer (OEM) suppliers supply or offer to supply means of implementing the invention protected by a patent when these means are essential elements of the invention, and where the third party knows or should know that such means are suited and intended for putting the invention into effect.

b. Standards for Infringement

i. IP Rights

Copyrights

French copyright law grants the author economic and moral rights, thus conferring on designers full control over their creations.

Economic rights include the rights to reproduce, represent, adapt and market the protected work. The exercise of any of these rights without authorization of the author amounts to copyright infringement. Moral rights includes the right for the author to choose to divulge his or her work to the public, to be identified as the author of the work, to oppose any distortion or modification of the work, or to withdraw the work previously disclosed to the public.

In the context of fashion designs and luxury goods designs, copyright infringement is constituted where the litigious work reproduces the copyrightable parts: i.e., the essential characteristics of the protected work. Copyright infringement is determined by taking into account the resemblances, not the differences.

Thus, if the litigious work reproduces elements that are banal or common in the fashion industry, correspond to a fashion trend insusceptible of appropriation, or only respond to technical necessity, there will be no copyright infringement. On the contrary, where the original features of the creation are reproduced, so that the litigious creation only departs from the protected work by minor alterations that do not allow the designs to be distinguished, there will be copyright infringement.

Designs

Design registration confer its owner with an exclusive right over the design, including the right to manufacture, offer, market, import, export, use or detain the product incorporating the design. The exercise of any of these rights without authorization of the owner amounts to design infringement.

The scope of protection is not limited to identical design and covers any design that does not produce a different overall impression on an informed observer. The scope of protection is further defined by the degree of freedom of the designer in making the design. Indeed, the less the designer is technically restricted in creating a design, the more he or she will be expected to depart from prior creations in order to avoid design infringement.

Trademarks

The owner of a registered trademark has the exclusive right to prevent third parties from using (i) signs identical to the prior trademark for goods or services identical to those for which the prior trademark is registered; (ii) signs identical or similar to the prior registered trademark, for identical or similar goods or services, if it may create a likelihood of confusion in the public's mind, and (iii) signs identical or similar to the registered trademark for dissimilar goods and services, if the registered trademark has a reputation in France, and if the subsequent sign takes unfair advantage of the distinctive character or of the reputation of the prior trademark, or is prejudicial thereto.

Any of the above acts exercised in the course of trade and without consent of the owner amount to trademark infringement.

Patents

Patent registration confers on its owner an exclusive right over the protected invention, including the right to manufacture, offer, market, use, import, export, and detain the product incorporating the patented invention. If the patent protects a process, the exclusive right is extended to the right to prevent third parties from implementing such process, as well as from offering, marketing, using, importing or exporting the product directly obtained from the relevant process. The exercise of any of these rights without authorization of the patent owner amounts to patent infringement.

Patent infringement occurs when the patented invention (as resulting primarily from the claims made out in the patent specification) has been reproduced in its essential elements.

ii. Unfair Competition/Passing Off

The legal basis for an unfair competition action can be found in articles 1382 and 1383 of the French Civil Code (general civil liability rules).

Pursuant to the principle of freedom of trade and industry, designers are free to create their collections by following current or past fashion trends, even though when doing so their designs may have features in common with those of their competitors.

Therefore, in order to succeed in a claim for passing off/unfair competition, the plaintiff would need to evidence a fault, damage, and a causal link between the fault and the damage.

Passing off (parasitism) requires evidence of fault, which may be defined as the behavior by which an economic agent interferes in the wake of another with the aim of making a profit, at no cost, from its efforts and know-how. Passing off does not require a situation of competition between the claimant and the defendant, or the demonstration of a likelihood of confusion.

Unfair competition requires the demonstration of an act/behavior that is contrary to honest (fair) business practices: e.g., the existence of acts aimed at creating a likelihood of confusion in the consumer's mind as to the origin of the products.

The distinction between passing off and unfair competition is not very clear in French case law, and therefore it is recommended not to distinguish between each ground, but, rather, to act on the general ground of unfair competition and passing off, pursuant to articles 1382 and 1383 of the French Civil Code.

To assess the likelihood of confusion in unfair competition cases, the court examines the resemblances between the products in relation to an average consumer, having normal attentiveness with regard to the nature of the product or the place where it is offered for sale.

In both unfair competition and passing-off cases, the scope of examination is not limited to the similarities between the products but is extended to all factors likely to demonstrate likelihood of confusion, including but not limited to the presentation of the product, its packaging, its retailing conditions, and the promotional and marketing strategy.

c. Remedies

i. Interim Injunctions

It is possible to seek interim injunctions through summary proceedings as regards both IP rights infringement and unfair competition/passing off.

When such action is brought, the claimant can obtain a wide range of provisional orders from the judge, such as prohibition measures, seizure of the allegedly infringing products, or even a provision as to the potential future monetary compensation to be awarded on the merits, if the prejudice is not seriously questionable.

Summary proceedings for copyrights infringement and unfair competition/passing off are governed by the common law of civil procedure ("*référés*"). Summary proceedings for other IP rights are subject to specific procedural rules in the IPC.

Copyrights Infringement and Unfair Competition/Passing Off

In a "*référé*" procedure, the judge does not hear about the merits of the case, and is therefore not supposed to do an in-depth analysis of both the validity of the copyright and the infringement.

The claimant may resort to two different types of common law summary proceedings.

Pursuant to article 808 of the French Code of Civil Procedure, the judge will grant interim measures if (i) there is urgency; and if (ii) the party applying for interim measures proves either that the measure cannot seriously be challenged by the other party or that the measure is justified by the existence of the dispute. Urgency is assessed on a case-by-case basis and there is no standard as to the required timing to react. However, interim measures are generally granted based on article 808 only if the infringement is about to occur (e.g., launching of a product, publication of a publication) or has just begun.

In addition, pursuant to article 809 of the French Code of Civil Procedure, summary proceedings may be introduced in order to require cessation of an obviously unlawful act. Indeed, the judge may always, even where confronted with a serious challenge, order in a summary procedure such protective measure or measures to restore the parties to their previous state as required, to avoid imminent damage or to abate a manifestly illegal nuisance.

The granting of an interim injunction does not preclude the award of a final injunction if an action on the merits is thereafter initiated. There is no time limit to bring a copyright infringement action or an unfair competition/passing-off action on the merits.

Other IP Rights Infringement

Designs, trademarks and patents are subject to specific rules for summary proceedings, set out in the IPC.

As these procedures are summary proceedings, the judge is not empowered to hear about the merits of the case (i.e., he or she is not supposed to do an in-depth analysis of both the validity of the IP right and the infringement).

The judge will only examine (i) whether the registered IP right (design, trademark or patent) is not manifestly subject to cancellation; and (ii) whether the evidentiary elements filed by the claimant are sufficient to show that it is likely that an infringement is occurring or about to occur.

When a preliminary injunction is sought before the launching of a legal action on the merits, the claimant has to bring an action on the merits of the case within 20 business days or 31 calendar days, whichever is longer. Otherwise, the provisional measures ordered are declared void upon request of the defendant.

ii. Civil Action on the Merits

The plaintiff can initiate an IP rights infringement action or an action based on unfair competition/passing off on the merits before the competent civil courts and claim for the following final civil remedies:

- injunctions (under penalty or not): destruction, removal of infringing products, recall of infringing goods from the market; and/or
- damages (which may only be compensatory, as opposed to punitive).

In Case of IP Rights Infringement

As financial compensation awarded by French courts to IP rights owners for infringement has often been relatively low, a new law, of 11 March 2014, is intended to improve and clarify the provisions regarding assessment of damages.

Under the new law, French courts have to identify distinctively the three possible heads of damages, which are (i) the negative economical consequences of the infringement; (ii) the moral prejudice; and (iii) the profits made by the infringer. The prior law already required the judge to take these three elements into consideration, but they were assessed together. By formalizing this requirement to distinguish the three heads of compensation, the new law should enable a more accurate and detailed assessment of damages awarded for infringement.

Regarding the "negative economical consequences", courts are now invited to compensate the victim not only for shortfall in earnings but also for the loss suffered: e.g., depreciation of the trademark value, loss of opportunity to enter into license agreements, or depreciation of the investments made by the IP rights owner.

In addition, "profits made by the infringer" should now include the savings made by the infringer in terms of intellectual and material efforts and in terms of promotion. Until now, the IPC only referred to profits made by the infringer, not to actual savings. These savings were usually sanctioned on the grounds of unfair competition.

Although the aim of this new law is to increase damages awarded by national courts for IP rights infringement, we do not know yet if the new wording of the IPC as regards the assessment of damages will result in any change in the practice of French courts.

In Case of Unfair Competition and Passing Off

There is no other legal basis to calculate the amount of damages in unfair competition actions.

The award of damages is calculated according to the principles of civil liability, and must include the loss incurred by the victim and the profit of which he or she was deprived.

Calculating the damages in unfair competition and passing-off actions is complex. Indeed, to be compensated, the prejudice must be certain, regardless of the fact that the prejudice is actual or future. The prejudice can be either material/economical (e.g., loss of customers, of contracts or profits) or moral (e.g., dilution of the name or of the image of the products/services). The prejudice must also be justified, meaning that the plaintiff must submit to the court precise evidence of its prejudice. The competitive harm is difficult to prove and to assess, since it is up to the victim of unfair acts to prove the influence of these acts on the volume of business related to its professional activities and its ability to compete. The other difficulty is to quantify that damage. Thus, the turnover of the plaintiff may give an indication of the impact of the actions, but this is not always the case. Indeed, the damage may also consist of a shortfall that will be hard to trace. Finally, the usurpation of the reputation of a company or product may also result in a reduction or dilution of this notoriety and therefore constitute another indication of the impact.

Judges have a sovereign power to assess damages, which are consequently determined on a case-by-case basis.

Publication of the Court's Decision

French courts can also order, at the claimant's request and at the defendant's cost, the publication of the judgment. This will enable the claimant to inform customers and the professional community.

d. Obstacles to Enforcement

The plaintiff who obtains a favorable decision from a French court might face several obstacles to the enforcement of the decision.

If the court orders the defendant to pay damages, the plaintiff can encounter difficulties in recovering sums of money if the defendant is not solvent. A preventive seizure can be granted by the court in specific circumstances.

The plaintiff might also face difficulties if the defendant is not a French citizen or French entity.

Indeed, enforcement procedures and the authorities that handle them are ruled by the national law of the state where enforcement is sought.

At the European level, there are two possible ways to seek enforcement in a Member State of a judgment rendered in another Member State:

- obtaining a declaration of enforceability in the Member State where enforcement is sought pursuant to the exequatur procedure laid down in regulation (EC) No 44/2001 on jurisdiction, recognition and enforcement of judgments in civil and commercial matters («Brussels I»); or
- obtaining an EEO in the Member State where the judgment is issued, in accordance with regulation (EC) No 805/2004.

2. Criminal Action

a. Source of Liability under Statute and Common Law

i. IP Rights Infringement

IP rights infringement may also give rise to criminal prosecution. Criminal enforcement in the context of fashion and luxury goods designs infringement is a very effective and relatively inexpensive tool. Indeed, the infringing goods are quickly removed from the market, with immediate economic pain inflicted on the infringer.

However, criminal action may be less attractive to IP rights owners, since the civil courts are considered much more effective in terms of compensatory damages. In addition, in criminal proceedings, the parties lose the lead of the proceedings to the public prosecutor, which may limit the possibility of negotiations. The standard of proof is higher in criminal proceedings, since, in addition to the material act of infringement, the bad faith of the infringer must be established. Finally, criminal courts (as opposed to civil courts) are not specialists in IP, and thus it is better to resort to criminal action for straightforward trademarks cases only, where the trademarks at issue are either identical or very close.

ii. Unfair Competition/Passing Off

Unfair competition and passing off cannot give rise to criminal prosecution.

iii. Criminal Liability of Legal Persons

French criminal law provides that legal persons, with the exception of the state, are criminally liable for the offenses committed on their account by their organs or representatives, and that the criminal liability of legal persons does not exclude that of any natural persons who are perpetrators or accomplices to the same act.

iv. Secondary/Contributory Criminal Liability

Under French criminal law, the accomplice to a felony or a misdemeanor is the person who knowingly, by aiding and abetting, facilitates its preparation or commission.

The accomplice to the offense is punishable as a perpetrator.

In order to be punishable, the complicity needs criminal intention in the accomplice to be found. This intention comprises (i) the fact that the participation act has been voluntary; and (ii) the consciousness and the will to participate to the main offense.

b. Standards for Infringement

Unlike civil action, criminal prosecution of counterfeiting requires defining both a material and an intentional element of the offense.

i. Material Element

Under criminal law, the following acts, without the consent of the owner of the IP rights, are prohibited:

- the manufacture, supply, marketing, importation, exportation, use or possession for these purposes, of a product incorporating a design. This protection conferred by the registration of a design extends to any design that does not produce on the informed observer a different overall impression;
- the editing, reproduction, performance or distribution of a copyright work;
- to do or to give orders or instructions for the commission of the following acts: import, export, re-export, tranship or industrially produce products incorporating a counterfeited trademark. Also prohibited are the possession and sale of such counterfeited goods. Finally, a third party is not authorized to reproduce, imitate, use, affix, delete or commute a trademark; and
- the manufacture, offering, putting on the market, use, importation or stocking of the product covered by a patent.

ii. Intentional Element

The intentional element implies that the offender was aware of the fact that he or she was committing an offense. However, there is real difficulty in proving this element in a counterfeiting action. Therefore, French criminal law has established a rebuttable presumption of bad faith of the infringer. As a consequence, the burden of proof is reversed to the detriment of the counterfeiter, who has to prove that he or she was not aware that the goods were protected.

c. Penalties

The IP rights holder can:

- file a simple complaint ("*plainte simple*") with the public prosecutor. If the prosecutor decides not to prosecute the case, it is possible to file a complaint with a specific request to prosecute the case ("*plainte avec constitution de partie civile*"). In such a case, the case will be prosecuted and the rights holder, as a civil party, will be entitled to request an injunction and compensatory damages against the infringer. The civil party who files such a *plainte avec constitution de partie civile* shall pay a deposit. The amount of the deposit is at the judge's discretion but can be as high as €15,000. The deposit is returned to the plaintiff unless he or she is sentenced to pay a civil fine (this would happen only if he or she has committed a fault or shown negligence in filing the complaint); and
- sue the infringer by direct prosecution in a criminal court ("*citation directe*"). In that case, no investigation is conducted.

The IPC and the Criminal Code provide for principal and additional penalties:

i. Principal Penalties

The author of an infringement of an IP right can be ordered to pay a fine of €300 to €500. The fine incurred is five times greater if the author is a legal entity.

A sentence of three to five years' imprisonment may also be pronounced against natural persons.

French courts may also order removal from the channels of commerce, the destruction of the infringing goods, seizure of all or part of the revenue derived from the infringement, and the publication of the judicial decision at the infringer's expense.

ii. Additional Penalties

Several other penalties are incurred by the infringer. For instance, total or partial closure, for a period not exceeding five years, of the entity that has served for the commission of the offense.

iii. Civil Party's Request for Damages

The IP rights owner can also request damages for the prejudice he or she suffered because of the infringement. The rules as regards the calculation of damages are the same as regards civil actions (see above). However, criminal action may be less attractive to IP rights owners, since the civil courts are considered much more effective in terms of compensatory damages.

d. Obstacles to Enforcement

The prosecutor and the civil party might face important difficulties if the defendant is not a French citizen or French legal entity. The prosecutor might therefore be reluctant to prosecute in such a case.

3. Administrative action

The competent French administrative authority as regards industrial property rights (trademarks, registered designs and patents) is the Institut National de la Propriété Industrielle (INPI).

a. Source of Liability

When it comes to defense of IP rights, INPI has jurisdiction only in opposition proceedings against the registration of French trademarks. INPI may refuse the registration of the trademark on relative grounds if an opposition is filed by the owner of a prior trademark application or registration having effect in France. The INPI decision can be challenged by the competent court of appeal.

There are no opposition proceedings as regards designs and patents in France.

b. Standards for Infringement

Under French law, an opposition may be based on an earlier trademark application or registration having effect in France, or an earlier well-known mark, pursuant to article 6bis of the Paris Convention.

The notice of opposition must state the grounds for the opposition: either reproduction of a prior trademark or imitation of the prior trademark with creation of a risk of confusion.

INPI will refuse the registration of a trademark that is identical to the earlier trademark and designates goods or services that are identical to the goods or services for which the earlier trademark is protected. If the signs and the goods and services are not identical, INPI will refuse to register the opposed trademark if there is a likelihood of confusion in the consumer's mind.

4. Customs

a. Enforcement Mechanisms

French customs deals with IP rights infringements on a daily basis. The role played by French customs is essential, since the majority of counterfeit goods in the fashion and luxury industries come from abroad.

French customs can act on several legal bases:

EU Regulation 608/2013

- intervention possible only at the borders;
- for all IP rights;

- only for non-EU goods (i.e., goods coming into the EU territory from non Member States) unless the non-EU good has transit/transshipment status (*Nokia-Philips case*[27]);
- requires cooperation of rights holders;
- possible measures: detention of goods with or without prior application, simplified destruction, simplified destruction for small consignments.

IPC

- intervention possible throughout all of the national territory (not only at the borders);
- for all IP rights;
- does not apply to EU goods legally manufactured or put into free circulation in a Member State and intended, after passing through the territory, to be put into circulation in another Member State for legal commercialization (EU – France – EU);
- does not apply to EU goods legally manufactured or put into free circulation in a Member State, in which they have been placed under transit status and that are intended, after passing through the territory, to be exported to a non member state (EU/transit – France – Non EU);
- requires cooperation of rights holders;
- possible measures: detention of goods with or without prior application, simplified destruction, simplified destruction for small consignments.

French Customs Code

- Intervention possible throughout all of the national territory (not only at the borders);
- for all IP rights (all IP rights infringements now constitute a customs offense);
- customs officers can act on their own initiative;
- customs have large powers: they can check the goods, visit professional and private premises, seize goods and documents, destroy goods, perform undercover and surveillance operations, and have access to the premises of postal providers and express freight companies when it is suspected that consignments containing or seemingly containing counterfeit goods are kept there. Moreover, infringers usually have to pay specific customs penalties.

b. Requirements for Enforcement

The EU Custom Regulation provides for two types of customs actions in the case of suspected counterfeit: actions based on earlier filed applications for action and *ex-officio* actions.

Under both procedures, customs detain the goods and notify the IP rights owner, who has to confirm the counterfeit nature of the goods. If the IP rights owner confirms counterfeit, customs will not release the goods, which will generally be destroyed. If the declarant, the holder or the owner of the detained goods opposes the destruction, court proceedings can be initiated. In the case of an ex-officio action, the IP rights owner has three working days to confirm the infringement.

[27] ECJ, 1st Dec. 2011, aff. C-446/09 and C-495/09, Koninklijke Philips Electronics NV c/ Lucheng Meijing Industrial Company Ltd et a. et Nokia Corporation c/ Her Majesty's Commissioners of Revenue and Customs

c. Considerations Relevant to the Enforcement Process

Filing applications for action with the customs authorities has the advantage that the IP rights owner is granted 10 days instead of three to confirm the counterfeit, and that customs will more easily stop counterfeit goods, as they will have been trained in recognition.

French customs are prone to seize and destroy goods on the basis of the Customs Code when IP rights owners confirm the infringing character of the goods. This has the advantage of avoiding the simplified destruction procedure (which requires consent to the destruction of the declarant, the holder or the owner of the detained goods).

D. Germany

[**Noted to Editor: parts highlighted in grey are copied from the UK section, which are equally applicable to Germany**]

1. Civil Action

a. Sources of Liability under Statute Law

Sources of Liability	***Rights Infringed***
German Patent Act (PatG)	Patents
German Utility Model Act (GebrauchsmusterG)	Utility models
German Trademark Act (MarkenG)	Registered and unregistered trademarks
German Design Act (DesignG)	Designs
German Copyright Act (UrhG)	Copyright
German Unfair Competition Act (UWG)	Potentially applicable to all aforementioned rights

b. Standards for Infringement

i. Patents

Patents are registered rights for technical inventions, granting to the holder of the patent the exclusive right to use the relevant invention as determined by the terms of his or her patent. According to section 9 of the PatG, a patent is infringed when a product that is the subject matter of the patent is made, offered, put on the market, used or imported or possessed for such purposes. Additionally, a patent is infringed when a process that is the subject matter of the patent is used or is offered for use. However, various exceptions, especially for private non-commercial use and scientific research, apply.

ii. Utility Models

Protection can also be sought for particular utility patterns (so-called utility models; GebrauchsmusterG). The requirements to obtain protection for a utility model are broadly similar to those for patent protection, with only slight differences regarding the aspects of novelty and inventiveness. Contrary to patents, however, the GebrauchsmusterG does not provide for protection of a manufacturing or processing method. Other than that, standards for infringement are oriented closely to those of a patent (see above).

iii. Registered and Unregistered trademarks

In principle, any sign that is capable of distinguishing the goods or services of different companies is capable of being protected as a trademark. The protection may include personal names, designs, letters, numerals, two and three dimensional shapes of goods or their packaging, sounds, and even smells. Apart from registration, trademark protection may accrue under the MarkenG through use of the sign in the course of business, if the sign has acquired a secondary meaning as a trademark, or by notoriety as a trademark.

According to section 14 of the MarkenG, in the course of trade, using a sign that is identical to the trademark for goods or services that are identical to those for which it enjoys protection, using a sign if the likelihood of confusion exists for the public because of the identity or similarity of the sign to the trademark and the identity or similarity of the goods or services covered by the trademark and the sign, including the likelihood of association with the trademark, or using a sign identical with or similar to the trademark for goods or services that are not similar to those for which the trademark enjoys protection if the trademark is a trademark that has a reputation in this country and the use of the sign without due cause takes unfair advantage of, or is detrimental to, the distinctive character or the repute of the trademark that has a reputation, constitute infringements.

iv. Designs

A design right protects the aesthetic aspects of industrial products, such as color and shape. These may include ornaments, textiles, devices, motor vehicles, labels, brochures, and other essentials creating the aesthetic difference between products in competition.

According to section 38 of the DesignG, a registered design is infringed when an identical or similar design is used, made, offered, put on the market, imported, exported, or a product is used or stocked, in which the design is incorporated or to which it is applied. Similarity is judged on the grounds that the design does not produce a different overall impression on the informed user than the registered design, when taking into account the degree of freedom of the designer. Exceptions are made, in particular, for private non-commercial use, experimenting and teaching.

In contrast to other European design rights, Germany does not recognize protection for unregistered designs.

v. Copyright

Copyright protection in Germany does not depend on a registration or an official grant. The protected work must exhibit a minimal amount of creativity. Originality is required to be demonstrated either in the form or the content of the work. It protects the expression of an idea, rather than the idea itself. The subject of a copyright may be a work of literature, science or art; in particular, linguistic works, works of music, dance, works of fine art, photos, film, presentations of a scientific or technical nature and also computer programs.

In a recent decision, the Federal Court of Justice of Germany significantly lowered the requirements for applied art to enjoy copyright protection (BGH, I ZR 143/12, 13.11.2013 – Geburtstagszug). Applied art now enjoys the same protection as fine art, and musical or literary works. Since products associated with the fashion and luxury goods industry mostly constitute works of applied art, this decision has a huge impact on these industries. Copyright protection for products associated with the fashion and luxury industry can now be claimed if such products reach the threshold of originality to be considered “artistic performances’.

The copyright owner has the exclusive right of commercial exploitation of his or her work. This includes the right to reproduce (section 16 of the UrhG), distribute (section 17 of the UrhG), exhibit (section 18 of the UrhG) and make available to the public (section 19a of the UrhG). However, these rights do not apply to, e.g., private copies, teaching and research.

As regards the emerging concept of 3D printers (as discussed above, in Part I, 1.2, (a)), copyright is not an effective means of protection against infringements. Even though, in accordance with the new decision of the Federal Court of Justice on applied art, the 3D product itself will most likely enjoy copyright protection, private copies are exempt from protection if not based on an obviously illegal template.

vi. Unfair Competition

Unfair competition encompasses the concepts of passing off, impeding free competition, violation of statutory and contractual obligations, slander, libel and deceptive advertizing, as well as other deceptive acts or practices, such as exploiting the naive or inexperienced. Consumers and competitors alike are protected against unfair trading practices by the UWG. The UWG prohibits business practices that prejudice the interests of competitors, consumers and others in the market.

In particular, the UWG prohibits: putting pressure on consumers to influence their decisions; exploiting the inexperience of children and teenagers; exploiting another’s reputation; concealing terms and conditions of discounts and games when advertizing them; slavishly imitating products not protected by IP rights; non-transparent and deceptive advertizing; advertisement of prior lower prices; and cold calling by phone, fax or email.

c. Civil Remedies

i. Cease and Desist Claims

The infringed is entitled to issue cease and desist claims against the infringer if a risk of repetition of infringement of IP rights is to be assumed or an infringement of such rights impends.

ii. Damages

The infringed party is entitled to claim damages. Three possible means of calculation are available, based on: (i) the infringer’s profits; (ii) lost profits of the infringed (ii); or (iii) a license analogy. The infringed is free to choose from the three different ways of calculation. However, damages may only be claimed if the infringer acted intentionally. German law does not provide for punitive damages.

iii. Claim for Disclosure

For the purpose of damage calculation, the infringed party may request disclosure of relevant information from the infringer, limited to the respective matters of dispute. The infringed party is entitled to be informed about the scope of the infringing acts. The claimant needs to geographically specify the territory to which the claim is restricted. Information sought can include sales figures and profits and, in particular, origins and distribution channels of goods and services. Claimants can demand detailed information on sales and profits, broken down to turnover and profit generated by each relevant product, divided by calendar quarters, indicating the production costs, including variable and fix production costs, as well as the advertizing activities' scope divided by calendar quarters, advertizing media, and including areas and terms of circulation.

Regarding origins and distribution channels, the information may include names and addresses of manufacturers, suppliers, previous owners, commercial customers and principles, as well as intended wholesalers and retailers, and information on the amount manufactured, delivered, received or ordered, as well as purchase and sale prices of the respective products, including copies of corresponding receipts.

Third parties can be claimed against if the infringement has a commercial character, if the claimant has already filed a suit or if the infringement is evident.

The UWG distinguishes between autonomous disclosure claims and dependent ones (i.e., accessory damage claims). The former applies only to the disclosure of information regarding the infringer, whereas the latter also applies to non-infringing third parties.

Destruction or Surrender of Goods

Every infringement of IP rights entitles the infringed party to claims for destruction of the relevant goods against the infringer. This does not, however, apply to violations of competition law.

In the case of copyright or design infringements, the infringed may instead choose to obtain the infringing goods that the infringer has in his or her possession. In that case, the infringed has to adequately compensate the infringer. The compensation must not exceed the manufacturing costs of the infringing goods.

iv. Preliminary Injunction

Preliminary injunction proceedings are a very effective and fast way to protect IP rights against current or threatening infringements. Preliminary injunction proceedings are usually ex parte, and a decision can be expected within a period of one to four days. Preliminary injunction proceedings are only admissible if the matter is urgent. A matter will usually no longer be deemed to be urgent if more than about four weeks have passed since the infringed party gained knowledge of the infringement. In addition, preliminary injunctions are generally limited to cease and desist claims. The competent courts specialize and are experienced in IP matters.

v. Recovery of Legal Costs

Under German law, the infringed party has a claim against the infringer for the recovery of legal costs. Depending on the value of the case, such a claim for costs might cover a significant part of the legal fees for the warning letter, as well as of the legal costs of the preliminary injunction and main proceedings.

d. Obstacles to Enforcement

Please see Part I, section 2.4.

2. Criminal Action

Infringements of any IP rights may constitute a criminal offense, provided that the infringer had the intention to commit the offense and provided that the infringement took place in the course of trade.

The IP rights holder may file a criminal complaint against the infringer. The responsible domestic criminal authorities will commence a criminal investigation. Such a criminal investigation can constitute a valuable source of information, as the holder of an IP right is entitled to access records.

The penalty for infringing an IP right can be imprisonment of up to five years, or a fine.

Especially in the case of fairs, where there is little time to wait for a court's decision, the public prosecutor and/or the police can seize counterfeited goods if there is sufficient proof that the goods to be seized are indeed counterfeits. This is a cost-efficient and quick way to stop infringers from displaying their counterfeited goods at fairs.

3. Customs

a. Enforcement Mechanisms

Germany has an elaborate and efficient framework for the protection of IP rights that includes a procedure to apply for the seizure of counterfeit goods and parallel imports from outside the EU and the European Economic Area (EEA) by German Customs. In recent years, German Customs has proven to be highly efficient in combating IP infringements. Filing an application with the Zentralstelle Gewerblicher Rechtsschutz (ZGR) – the competent administrative body – is therefore both recommended and cost-effective.

Through the filing of a customs application, border and customs offices in Germany may stop or seize suspected goods during the customs clearance process. A customs application may be filed by the holder of the IP right, a licensee or a representative under power of attorney. An application can be filed in relation to trademarks, copyright, designs, patents, utility models, and other IP-related rights.

There are two types of customs applications that can be filed in Germany. Generally, applications are to be filed under European Regulation (EU) 608/2013. German national applications are only available in cases not covered by the European Regulation, these being parallel imports, movement of goods within the EU and so-called overruns. Where an application under the European Regulation refers to Community rights, such as Community trademarks or Community designs, the application can be filed in one Member State but designate further Member States where the application is also intended to be filed. Customs will – provided that all conditions are met – forward the application to the customs authorities of the designated Member States. An application remains in force for up to one year.

These mechanisms do not apply to goods in the personal luggage of travellers or to postal services for private purposes.

b. Requirements for Enforcement

Once goods have been seized by German Customs, the designated receiver of the goods will be notified within one working day. He or she can then choose to either consent to the destruction of the goods or to object. Customs will also notify the rights holder of the detention, and invite him or her to confirm whether or not he or she believes the goods are infringing, and if so, whether he or she agrees to destruction. All parties have the right to inspect the consignment, and the rights holder may request samples.

Goods will be destroyed when the rights holder confirms in writing that the goods infringe an IP right covered by the application and the declarant also agrees to the destruction of the goods. Customs may assume consent has been given if the rights holder confirms the goods infringe IP rights covered by the application and the declarant fails to respond to customs within 10 working days.

If the declarant or holder of the goods objects to their destruction, customs will notify the rights holder. If the rights holder does not provide satisfactory evidence to customs before the end of the detention period that he or she has initiated proceedings to determine whether his or her IP right has been infringed, the goods must be released from detention.

Regulation (EU) 608/2013 establishes the so-called "simplified procedure" for all EU Member States where previously only 15 had implemented such proceedings. Goods halted by customs can be seized and destroyed if the importer does not contest the seizure within 10 working days. Provided the goods are counterfeit, it is common practice to ask the parties involved to give a voluntary declaration of consent to the destruction of the counterfeit goods. It is our experience that, in the vast majority of cases, this approach leads to satisfying results. Only if the importer contests the seizure is action in court necessary. Silence is considered consent.

Additionally, regulation (EU) 608/2013 introduces a "super-simplified procedure" that applies to goods sent in small consignments. This means a maximum of three units or a gross weight of not more than two kilograms. The rights holder may choose to take part in these proceedings when filing the customs application. If he or she chooses to do so, the customs authorities inspect relevant goods on their own and decide independently on the destruction of the goods. This means that the rights holder will only be involved in the proceedings if the importer does not consent to the destruction within the 10-day time frame.

Considerations Relevant to the Enforcement Process

Customs issues strict deadlines when processing detained goods. As such, there is a risk that alleged counterfeit goods will be released should a deadline be missed, so rights holders must act quickly upon receiving notification of a seizure.

Building a strong relationship with customs officials enhances their awareness of the registered brands and products. Providing customs with examples of new lines and product ranges also ensures that officials have a overall view of the IP rights that are protected.

E. Italy

1. Civil Action

a. Sources of Liability under Statute and Common Law

Sources of Liability	***Rights Infringed***
Italian Code of Industrial Property (Legislative Decree No. 30 of 10 February 2005) (IPC)	Trademark, design, patent and utility model
Italian Copyright Law (Law No. 633 of 22 April 1941) (Copyright Law)	Copyright
Section 2598 of the Italian Civil Code	Unfair competition

i. IP Rights Infringements and Unfair Competition

Civil litigation involving IP matters is referred to a limited number of courts divisions specializing in business matters.[28] The IP rights holder can bring a civil action before the competent courts based on:

- trademark infringement (including registered and unregistered trademarks);
- design infringement;
- patent infringement;
- copyright infringement; and
- unfair competition.

Italian law allows consolidation of legal actions involving trademark, design, patent, copyright and unfair competition issues that present a connection with IP rights in a single lawsuit.

If the relevant fashion designs and luxury goods are not protected by any registered IP right, the claimant may seek protection against slavish imitation lookalikes, knock-offs or free-riding on the ground of unfair competition provisions. In such cases, infringing claims will be based solely on unfair competition and the proceedings will be held before ordinary civil courts.

ii. Secondary/Contributory Liability

Contrary to the law on ISP liability, Italian legislation does not include any specific provision addressing secondary/contributory civil liability of landlords, carriers or transporters of counterfeits and pirated goods. Indeed, pursuant to the IPC, only individuals who manufacture, hold for sale, sale or otherwise distribute industrial products bearing deceptive trademarks are directly responsible for counterfeiting, provided that such possession takes place on a commercial level.

Although the IPC does not directly address contributory infringement, it is commonly accepted both by courts and commentators that the "*means specifically used to produce the*

[28] Currently, there are 21 across the country, located in Milan, Brescia, Turin, Trento, Venice, Trieste, Genoa, Bologna, Ancona, Cagliari, Campobasso, Catanzaro, Florence, l'Aquila, Perugia, Rome, Potenza, Naples, Bari, Palermo and Catania.

patented product or to implement the protected method or process" may be subject to seizure in an infringement action and subsequently destroyed or assigned to the owner of the allegedly infringed patent, even if it does not belong to the direct infringer. In this case, and provided there are certain conditions, action could also be possible against third parties (e.g., a producer of a specific component unequivocally intended to be embodied in an infringing device).

According to the most recent case law, contributory infringement occurs only where the following two conditions are both met: (i) that the means supplied by the third party are exclusively intended for the realization of the invention; and (ii) that the supplier of the means is aware of the intention of the purchaser to infringe.

b. Standards for Infringement

i. Trademark Infringement

Under section 20 of the IPC, a trademark is infringed when an identical mark is used in the course of trade in respect of identical goods or when an identical sign is used with similar goods, or a similar sign is used with identical goods, and there exists a likelihood of confusion on behalf of the public. An extended protection is granted to marks that have a national reputation, provided that the second sign derives unfair advantage from the distinctive character or the reputation of the earlier trademark, or is prejudicial thereto.

ii. Design Infringement

According to section 41 of the IPC, a registered design is infringed when a second design is used that does not produce a different overall impression on the informed user (taking into account the degree of freedom of the designer). "Use" has been defined as the making, offering, putting on the market, importing, exporting or using of a product in which the design is incorporated or to which it is applied, or stocking such product for those purposes.

Unregistered designs do not enjoy any protection under the IPC, but, conversely, may be enforced under unfair competition rules.

iii. Patent Infringement

Patent infringement is established when the patented invention (as resulting primarily from its claims) has been reproduced in its essential elements. Literal reproduction of all elements of the inventive idea is not strictly necessary in order to qualify as an infringement. On the other hand, there is no infringement if only one of the features of a claim is reproduced and this feature is not essential to the patent.

iv. Copyright Infringement

The Copyright Law grants the author of a work both moral and economic exclusive rights. Each of these rights is independent and the exercise of any of them by an unauthorized individual triggers copyright infringement. However, the test for infringement depends on the relevant infringed right. With reference, e.g., to the exclusive reproduction right, the unauthorized copying of all or part of the protected work is, in principle, considered copyright infringement.

Nevertheless, the infringement of fashion goods design requires that at least a substantial part of the work is copied.

v. Unfair Competition

An act of unfair competition is established when third parties: (i) use names and marks that are capable of creating confusion with the lawful use of names or marks by other companies, or by imitating a competitor's product, or by acting so as to create confusion with the products and activities of a competitor; (ii) reveal information and comments on a competitor's product and activity so as to bring discredit to it, or arrogating qualities of the company's products or of a competitor; and (iii) adopt measures in breach of correct professional principles and that are capable of damaging other companies' business.

c. Remedies

Both the IPC and the Copyright Law – though similar measures are also available in the case of unfair competition – provide for a wide range of interim and final civil remedies, including injunctions, destruction, removal or assignment of infringing products, recall of infringing goods from the market, damage compensation, publication of the court's order/decision, and penalties in case of non-compliance with the court's orders. Disclosure orders against the infringer or other subjects involved in the infringement are also available to the rights holder, when necessary to obtain information about the origin and the distribution network of the infringing goods or services.

Provisional remedies can be granted either before or during an ordinary infringement action. To obtain a preliminary order, the claimant must file a motion with the competent court. Preliminary orders can only be granted – after the judge conducts a summary evaluation of the facts – if the following two conditions are met:

- the "*fumus boni iuris*" requirement, i.e., the claim shall appear prima facie grounded, and preliminary evidence shall be provided as to the validity and infringement of the IP rights; and
- the "*periculum in mora*" requirement, i.e., the claimant must prove that there is an actual risk that relevant evidence may be destroyed or concealed by the defendant, and that it may not be possible to obtain it later on during the ordinary proceeding.

Ex parte orders (i.e., without the possibility for the defendant to be heard before the order is granted and enforced) may be obtained in cases where the nature and magnitude of the infringement trigger the risk that the defendant will alter the facts and/or destroy or conceal the relevant evidence, thus nullifying in practice the enforcement of the measure. Italian courts are, however, quite reluctant to grant preliminary orders *ex parte* (in particular, regarding measures such as seizure that may have a strong economic impact on the counterparty).

The typical provisional remedies set forth by the IPC are:

- <u>Search and description</u> This remedy is aimed at searching for and describing the allegedly infringing goods, the manufacturing means and any other elements concerning the infringement, to obtain evidence to be used during the civil action. This remedy is particularly important for gathering evidence during trade fairs or other similar exhibitions, since it is the only (civil) remedy allowed in these contexts. Search orders permit the rights holder to access the defendant's premises with the attendance of the court bailiff, and, where required by the technical nature of the infringement, a technical expert appointed by the court, for the purpose of describing and collecting evidence on the infringement.

- Seizure This remedy has two goals: to prevent the marketing of certain goods and gather evidence for the civil action.
- Injunctions This remedy is aimed at obtaining immediate cessation of any manufacturing, marketing and use of infringing goods. Penalties are usually available as a restraint measure against possible breaches of injunction orders.
- Withdrawal of the infringing goods from the market
- Preliminary technical opinion This is quite a new remedy. Everything is placed in the hands of the technical expert, who, before an ordinary proceeding is started, expresses his or her opinion either on the validity of an IP right or on its infringement. It can be requested only prior to and independently from the action on the merits. It differs from the other provisional remedies, since it does not require urgency. This remedy is usually used to reach an agreement between the parties or as a useful element of proof in a possible subsequent action.

The IP rights holder may also obtain an order against the infringer and/or any other persons involved to disclose the documents and information on the origin and distribution networks of the infringing goods. Publication of the preliminary decision may also be requested.

In addition, according to the general rules on civil procedures (article 700 of the Italian Civil Code of Procedure) the rights holder is entitled to ask for any other provisional remedy, not specifically provided for by the Italian IP Code, where deemed suitable to protect his or her rights.

Injunction, seizure and withdrawal of goods are also typical remedies claimed in ordinary actions on the merits. Damages can, indeed, be awarded, only if the infringement has been ascertained in an action on the merits. Damages can be alternatively calculated on the basis of (i) loss revenues; (ii) unfair profits made by the infringer (account profits); or (iii) the amount of royalties or fees that would have been due if the infringer had requested authorization to use the IP right in question. Moral damages may also be awarded. Punitive damages are not awarded under Italian law.

When the damages suffered cannot be ascertained in their exact amount, the judge may resort to an equitable assessment in accordance with the rule set forth by section 1226 of the Italian Civil Code. However, this assessment, which is based on the evidence submitted in the proceedings and the presumptions arising from it, requires: (i) sound evidence of the existence of an effective prejudice; and (ii) guidance on how to determine the amount of damages.

Publication of the judgment in one or more newspapers is usually requested, and is often granted by judges.

d. Obstacles to Enforcement

Enforcement of search orders may be difficult in practice, especially where the defendant offers little or no cooperation, thus making the location, identification and description of the relevant products and documents difficult. Furthermore, the court bailiff enforcing the order may be reluctant to access documents and files that do not clearly fall within the scope of the court's order. All this often leads to an incomplete and unsatisfactory enforcement of the order.

Sometimes, issues also arise in connection with damage compensation. Enforcement of damages-awarding decisions becomes difficult, or even impossible, in cases of hidden and/or a lack of infringer assets.

2. Criminal Action

a. Sources of Liability

Sources of Liability	***Rights Infringed***
Sections 473–474 and 517 of the Italian Criminal Code	Trademark, design, patent and utility model
Section 171 of the Copyright Law	Copyright

i. IP Rights Infringement

Infringement conduct that is relevant from a civil law standpoint often also represents a criminal offense, sanctioned with harsh penalties under the Italian Criminal Code.

In the field of fashion and luxury goods, criminal enforcement has recently become very popular for the purpose of tackling IP rights infringements.

The Italian Criminal Code identifies different conducts related to trademark, distinctive signs, designs, industrial models and patents infringement that constitute a criminal offense:

- section 473 qualifies as a criminal offense the act of counterfeiting, the alteration or use of trademarks, distinctive signs of industrial products, patents, designs or industrial models;
- section 474 qualifies as a criminal offense the act of introducing within the Italian territory, marketing or holding for marketing, with the purpose of obtaining profits, industrial products bearing counterfeited trademarks or distinctive signs; and
- section 517 qualifies as a criminal offense the sale of intellectual creations and industrial products bearing deceptive trademarks or distinctive signs that are potentially misleading for the purchaser as to the origin, provenience or quality of the products.

In addition to the Criminal Code, the Copyright Law criminalizes acts such as unauthorized reproduction and sale of a copyrighted design/work.

Although criminal liability is personal in Italy, liability related to infringing IP rights may be extended to legal entities. Legal entities can be prosecuted and ascertained as criminally liable for offenses, including trading of counterfeit goods and copyright infringements, formerly reserved for natural persons.

ii. Unfair Competition

Acts relevant from an unfair competition perspective do not give rise to criminal liability.

iii. Secondary/Contributory Criminal Liability

Secondary/contributory liability may be assessed on the basis of the general principles of Italian criminal law on "complicity in a crime" (section 110 of the Italian Criminal Code). The criminal liability of the accomplice person (e.g., the carrier/transporter) in relation to the crime committed by the "main" counterfeiting entity/person is ascertained on a case-by-case basis, and there must be evidence of (i) awareness by the accomplice person of the criminal intent of the main counterfeiting entity (e.g., the manufacturer and/or seller); and (ii) willful contribution to the accomplishment of the criminal activity or any part thereof.

b. Standards for Infringement

The IP-related offenses require "general intent", which means that the perpetrator acted consciously and willfully.

c. Penalties

Criminal actions are brought and conducted by the public prosecutor, rather than by the rights holder, as per civil proceedings. Upon receiving any information on an alleged infringement, the public prosecutor is obliged to initiate *ex officio* a criminal investigation into the matter, seeking cooperation from any relevant police authority. What makes a criminal action so powerful is the particularly intense involvement of police authorities in the collection of evidence, whether before or during the trial phase, and always under supervision of the public prosecutor.

Different types and level of penalties are provided by the Italian criminal law, and can be summarized as follows:

- trademarks counterfeiting or alteration: imprisonment for up to three years and a fine of €2,500 to €25,000;
- patents, designs and industrial models counterfeiting or alteration: imprisonment for up to four years and a fine of €3,500 to €35,000;
- introduction of counterfeit goods into the Italian territory: imprisonment for up to four years and a fine of €3,500 to €35,000;
- sale of counterfeit goods: imprisonment for up to two years and a fine of up to €20,000; and
- sale of intellectual creations and industrial products bearing deceptive trademarks or distinctive signs: imprisonment for up to two years and a fine of up to €20,000 (section 517).

Special criminal penalties are provided by section 171 of the Copyright Law. For unauthorized reproduction of a copyrighted design/work, there is a fine of €51 to €2,065.

Additional remedies are provided under the Italian Criminal Code and the Code of Criminal Procedure, and include inspection of premises and seizure of counterfeit goods, as well as, if appropriate, of instruments used for their production (section 474 of the Criminal Code, and sections 352–354 of the Code of Criminal Procedure).

Recourse to criminal enforcement to protect trademarks and designs of products in the fashion and luxury field represents a very effective, rapid and relatively inexpensive tool: infringing goods are quickly removed from the market, with immediate economic pain inflicted on the infringer.

Criminal enforcement is carried out directly by the Italian Tax Police (*Guardia di Finanza*), which has the power to make test purchases, enter the infringer's premises and seize the infringing goods. The Tax Police may intervene both upon notice from the rights holder – and, in this case, the rights holder can take part in the police's initiatives – or *ex officio*.

d. Obstacles to Enforcement

Please see section 1 d) above.

3. Administrative Action

a. Sources of Liability

i. Administrative Trademark Opposition Procedure

The Italian Patents and Trademarks Office (*Ufficio Italiano Brevetti e Marchi*) (UIBM) is the competent Italian authority with regard to IP rights.

UIBM is not only responsible for the registration of trademarks, patents and designs with validity in Italy, but also contributes to determining the strategies in response to IP infringement trends in Italy. Since July 2011, it also has jurisdiction in opposition proceedings against trademarks applications.

The trademarks applications that can be opposed through the administrative trademark opposition procedure are: (i) Italian trademark applications filed as of May 2011; and (ii) international trademarks published in WIPO's official gazette as of July 2011.

The terms for establishing the procedure are: (i) for Italian trademark applications, three months from publication in the national official gazette; and (ii) for international trademarks, three months from the first day of the month subsequent to the publication of the trademark in WIPO's official gazette.

There are no opposition proceedings as regards designs and patents in Italy.

b. Standards for Infringement

The prior rights on which it is possible to ground a valid opposition are as follows:

- previous applications/registrations of national trademarks, Community trademarks or international trademark registrations designating Italy;
- the right to one's name if its use as a trademark is such as to harm the reputation, standing or respectability of the individual entitled to such name;
- the right to the image object of the trademark; and
- the right to the well-known name or sign used in artistic, literary, scientific, political or sports fields, well-known denominations and abbreviations of exhibitions, or distinguishing and well-known signs and emblems of organizations and associations.

The subjects who can file an administrative trademark opposition procedure are:

- owners or exclusive licensees of trademark applications/registrations, as listed above;
- owners of image rights or personal name rights; and
- owners of well-known names or signs, as per the above.

UIBM will refuse the registration of a trademark that is identical to the earlier trademark and designated goods or services that are identical to the goods and services for which the earlier trademark is protected. When signs and goods/services are not identical, UIBM will refuse to register the opposed trademark if there is a likelihood of confusion in the consumer’s mind.

4. Customs

a. Enforcement Mechanisms

Another instrument to enforce IP rights is provided by national and EU customs notices filed in accordance with EU Regulation No. 608/2013. The Italian Customs Agency, within the framework of its statutory activities, usually conducts controls aimed at identifying counterfeit and pirated goods entering the national borders. As a general rule, Italian Customs can take action and seize goods coming from extra-EU countries and trespassing Italian borders.

b. Requirements for Enforcement

IP rights holders wishing to prevent infringing products from entering the EU borders can file an “Application for Action by the Customs Authority” (customs notice) either covering the territory of Italy, the whole of the EU or selected countries therein.

A customs notice may be based on trademarks, designs, copyrights and patents. It contains, e.g., the proof of validity of the IP rights within the territory concerned, and information for customs that is useful in identifying goods violating the relevant IP rights. Then, when customs detects potentially infringing goods, it detains them and asks the IP rights holder to confirm whether they are genuine or not. If a customs notice is not in place and customs stops suspected infringing goods on its own initiative, customs invites – where possible – the relevant IP rights holder to file a customs notice within few days.

c. Considerations Relevant to the Enforcement Process

There being in place a proper customs notice under EU Regulation No. 608/2013, the Italian Customs Agency conducts controls aimed at identifying counterfeit and pirated goods entering the national borders, employing for this purpose all the instructions and indications in the customs notice.

The so-called simplified procedure has not been implemented in Italy. After each seizure, customs will inform the competent public prosecutor, which will carry out the necessary investigations and, if appropriate, start criminal proceedings against the infringers, which may lead to destruction of the products. In this case, the IP rights holder is not required to take any initiative in the continuation and success of the trial.

The competent authorities (customs, as well as the police and others) would, in any case, take action, on their own initiative, against goods or practices suspected of violating any IP right. It is evident, however, that the customs notice is the easiest way to provide the authorities with the necessary information to best recognize an infringement when they see it.

Customs issues strict deadlines when processing detained goods. As such, there is the risk that alleged counterfeit goods will be released should a deadline be missed, so IP rights holders must act quickly upon receiving notification of seizure.

F. Spain

1. Civil Action

a. Sources of Liability under Statute and Common Law

The main sources of civil liability in Spain are:

- trademark infringement (including registered trademarks and unregistered but well-known marks);
- design infringement;
- copyright infringement; and
- passing off/unfair competition.

Spanish law permits the consolidation of legal actions relating to trademark, design and copyright infringements in a single lawsuit. With regard to passing off, the law also permits its consolidation, as long as the facts supporting this action differ from the facts on which the rest of the legal actions are based. This is so that the relevant facts concerning the merits of the case are not duplicated.

Sources of liability include secondary/contributory liability for infringement.

b. Standards for Infringement

- Trademark infringement: Spanish trademark law confers protection based on both likelihood of confusion and/or the well-known character of the mark. The following, in particular, may be prohibited: placing the infringing sign, offering, marketing or storing the relevant goods, importing or exporting the goods.
- Design infringement: the scope of protection granted by a Spanish registered design shall include any design that does not produce on the informed user a different overall impression.
- Copyright infringement: Spanish copyright law punishes unlawful copies, distribution, communication to the public and transformation of any copyright work.
- Passing off/unfair competition: for a valid cause of action for unfair competition, it is required there be shown a misrepresentation by the defendant in the course of trade to prospective or ultimate consumers of goods or services provided by him or her, which is calculated to injure the business or goodwill of the claimant (in the sense that it is a reasonably foreseeable consequence), and that causes actual damage to a business or the goodwill of the claimant, or will probably do so.

c. Remedies

On the basis of trademark, design and/or copyright infringements, and/or passing-off actions, it is possible in Spain to claim in civil actions for the cessation of the infringing acts, compensation of damages, the adoption of measures necessary to avoid the continuation of the infringement (such as withdrawal of the goods and advertizing materials), the destruction or transfer for humanitarian purposes of the infringing goods, and publication at the guilty party's expense of the court decision.

These remedies shall be requested in the corresponding lawsuit to be filed before the appropriate Spanish court.

Procedural civil law also allows for injunction measures, which may be requested prior or simultaneously to the claim on the merits. In order to support interim measures, the claimant must show a *fumus boni iuris* (existence of a justiciable claim) and *periculum in mora* (the urgent need for a seizure order).

Spanish law allows for compensation of damage caused, which covers not only the looses suffered but also the gains not obtained as a result of the infringement. In order to calculate the gains, the law employs, at the injured party's discretion, the following criteria: (a) the profits obtained by the claimant if the infringement had not taken place; (b) the profits that the infringing party obtained as a result of the infringement; or (c) the price that the infringing party would have had to pay for the grant of a license.

While Spanish case law requires the claimant to submit evidence in order to corroborate the existence of damage, Spanish trademark and design law foresees the right to receive, in any case and without the need for any proof, as compensation for damage 1 percent of the turnover of the infringing party resulting from the unlawful goods, services or designs.

d. Obstacles to Enforcement

In Spanish civil proceedings, there are no general obstacles to the enforcement of IP rights. The major issues normally arise in relation to the burden of proof on the claimant. All the evidence that supports the case on the merits must be filed within the main claim; otherwise, the submission of new evidence might be considered time barred (except for in a few very specific cases).

2. Criminal Action

a. Sources of Liability under Statute and Common Law

The Spanish Criminal Code (Law 10/1995, 23 November) provides protection against:

- trademark infringement (including Spanish registered trademarks, registered Community trademarks, international trademarks that designate Spain and Spanish trade names) – offenses related to trademarks are regulated by article 274 of the Spanish Criminal Code. Unregistered trademarks that are "well known" in Spain within the meaning of article 6 of the Paris Convention are not protected under the Criminal Code;
- design infringement (including registered Community designs and Spanish registered designs). – offenses related to designs are regulated by article 273.3 of the Spanish Criminal Code. It provides protection under criminal law for industrial or artistic models or designs; and
- copyright infringement – offenses related to copyright (IP rights) are regulated by articles 270 and 271 of the Spanish Criminal Code. They provide protection under criminal law for the relevant IP rights.

b. Standards for Infringement

- Trademark infringement is considered to be a criminal offense if it reproduces, imitates, amends, usurps in any other way or imports (including commercializing imported

products) a distinctive sign that is identical to or may be mistaken for the registered sign, to distinguish the same or similar products, services, activities or establishments for which the IP right is registered.
This offense requires that the above-mentioned activities be handled by the offender: (i) for industrial or commercial purposes; (ii) without the consent of the holder of the registered right; and (iii) in full awareness of the registration of the sign.

- Design infringement: article 273.3 of the Spanish Criminal Code punishes whoever manufactures, imports, possesses, uses, offers or markets objects protected by an industrial or artistic model or design. Thus, the design of a piece of jewelry, a perfume bottle, bags, shoes or any other luxury item, which are protected under design registration, may also obtain protection in criminal proceedings.
  The offense requires that the offender acts (i) for industrial or commercial purposes; (ii) without the consent of the holder of the right; and (iii) in full awareness of the registration of the design.
- Copyright infringement: section 1 of article 270 of the Spanish Criminal Code punishes whoever reproduces, plagiarizes, distributes, transforms, interprets or performs in any kind of medium or broadcasts by any medium a literary, artistic or scientific work, such as a fashion design, a pattern, a drawing or any other fashion work.
  The Criminal Code expressly states that the referred actions will be punished in case they affect all or part of the literary, artistic or scientific work involved. Thus, an infringement of a part of a work is sufficient for the offender to be punished.
  Section 2 of article 270 establishes that the intentional export and import or storage of works, productions or performances without due authorization will also be punished.
  It is required that the offender act (i) for profit and to the detriment of a third party; and (ii) without authorization by the holders of the relevant IP rights or their assignees.

c. Penalties

In order to enforce these rights, a criminal offense shall be filed before the Spanish criminal authorities. The proceedings will then be handled by the Spanish criminal courts. An offender may be punished with imprisonment for six months to two years, and a per diem fine of from 12 to 24 months for all the above-mentioned offenses regulated by articles 274, 273.3 and 270 of the Spanish Criminal Code. Depending on the circumstances and the amount of financial profit, these penalties may be lower.

Likewise, other special circumstances are considered in order to determine whether a higher penalty should be imposed on the offender. These are, e.g., when the profit obtained is of particular economic importance; or when the events are especially serious, in view of the value of the objects unlawfully produced or the special importance of the damages caused, etc.

Apart from penalties, the Spanish Criminal Code provides the right to reparation of the damage caused to the damaged party due to the offense or misdemeanor. Such civil liability includes restitution, repairing the damage, and payment of compensation for material and moral damages.

If the offender is a corporation, it may also be held civilly liable.

d. Obstacles to Enforcement

One of the most important challenges in criminal proceedings in Spain is to provide evidence regarding the offender's general intent and willingness to engage in the conduct punished by the Criminal Code.

In relation to offenses against trademark and design registrations, the law requires evidence that the offender was aware of the registration that has been infringed. In many cases, this is another obstacle to achieving penalties.

Since in Spain the registration of a copyright is not mandatory, nor is it necessary in order to obtain protection over original and artistic works, the Spanish Criminal Code requires evidence regarding the offender's general intention to engage in the illegal activity and his or her awareness that the infringed designs are owned by a third party.

Some examples of such evidence are as follows: (i) in relation to the facts, when the offender kept the infringing products hidden in a store (being aware that this was illegal) and only offered them on demand, and when original products or catalogues published by the owner of the trademarks or designs have been found in the infringing establishment; (ii) the offender worked in the fashion and retail businesses for a long time, and thus could be considered an expert; and (iii) the offender has continued to infringe after the rights holder sent a cease and desist letter.

In order to provide evidence of the profit obtained by the offenders, judges usually request that the offender provide the court with invoices and other relevant documents. In some circumstances, it may be advisable to file additional evidence, such as accounting reports.

3. Administrative Action

Administrative action is not applicable to Spain.

4. Customs

a. Enforcement Mechanisms

The customs authority in Spain is the Customs Department of the Tax Agency. This body has the responsibilities conferred on customs authorities by European Regulation 608/2013.

In particular, the Spanish customs authority's mechanisms to enforce IP rights are as follows: supervision and control within the Spanish territory of goods suspected of infringing an IP right; suspension of the release or detention of the goods before or after the grant of an application submitted by the rights holder; inspection of the goods the release of which has been suspended or that have been detained; the obtaining of samples and providing them to the right holders in order to analyze them; destruction of goods under customs' control.

b. Requirements for Enforcement

Rights holders can submit a Spanish or an EU application to the Tax Agency in order to initiate customs proceedings.

The Tax Agency is entitled to suspend the release of goods suspected of infringing an IP right or to detain them.

c. Considerations Relevant to the Enforcement Process

It is advisable for the rights holder to update regularly his or her knowledge of the list of IP rights enforced by the Tax Agency.

By amending the application, the rights holder may keep the customs authorities informed as to the rights it owns.

G. Russia

1. Civil Action

a. Sources of Liability under Statute and Common Law

Pursuant to Part IV of the Civil Code, any business activity that violates the exclusive right to a trademark constitutes trademark infringement. Such activity includes the unauthorized manufacture, use, import, export, sale or any other commercial introduction of a trademark that is identical or similar to the point of confusion with respect to the same or similar services and goods.

The trademark owner has the exclusive right to dispose of the trademark for the individualization of the goods, work or services with respect to which the trademark has been registered – in particular, by using a trademark:

- on goods including labels and packaging of goods, that are produced, offered for sale, sold, displayed at exhibitions and fairs, or otherwise introduced into the market within the territory of the Russian Federation, or are kept or transported for this purpose, or imported into the territory of the Russian Federation;
- while performing work or rendering services;
- on documents introducing goods into civil circulation;
- while offering goods for sale, work for performance, and services for rendering, as well as in announcements, on signboards, and in advertizing; and
- on the internet, including in a domain name and for other types of addresses.

No one has the right to use, without the permission of the rights holder, signs similar to his or her trademark with respect to the goods for the individualization of which the trademark has been registered, or similar goods, if such use would result in a likelihood of confusion in the minds of consumers.

If a trademark is used by a third party in any of the above ways without a license or the consent of the trademark owner, such use shall constitute trademark infringement, and can give rise to civil, criminal and administrative liability.

While a civil lawsuit may be initiated by the trademark owner in any case of unauthorized use of an identical or confusingly similar designation for the same or similar kind of goods and services, administrative and criminal proceedings are initiated by the police or other bodies (see below), depending on the gravity of the offense. To qualify for criminal proceedings, the infringement must have caused substantial damage to the trademark owner or consumers. A civil claim may be filed within the framework of a criminal trial, but to obtain damages in the case of administrative liability, the trademark owner must file a civil lawsuit in parallel.

Importantly, apart from the liability of IPSs as described above, Russian law does not provide for the possibility of prosecuting third-party facilitators, landlords, domain name registries and other third parties who directly or indirectly contributed to a trademark infringement.

b. Standards for Infringement

A trademark infringement claim is substantiated when the following three criteria are demonstrated:

- the unauthorized use of a sign that is identical or similar to the trademark to the point of confusion;
- the use of a trademark as part of an economic or business activity; and
- the use of a trademark on goods or in relation to services of the same kind.

c. Remedies and Penalties

Under article 1515 of Part IV of the Civil Code, goods, labels or packaging bearing unauthorized reproductions of a trademark or a designation confusingly similar to it are considered counterfeit.

The trademark owner is entitled to request the following remedies:

- cessation of the infringing activities;
- withdrawal of counterfeit products from the market and removal of trademarks from the counterfeits at the infringer's expense;
- reimbursement of damages or payment of statutory infringement compensation in the amount of:
  - RUB10,000 to RUB5 million;
  - double the price of the counterfeits; or
  - double the cost of a license granted under comparable circumstances for the lawful use of a trademark.

Please note that the amount of statutory compensation does not depend on the actual damage incurred.

d. Obstacles to Enforcement

Disputes are resolved on the basis of the evidence disclosed by the parties. There is no discovery available in Russian courts, and therefore it is often difficult for a claimant to estimate and show the volume of the infringing activities and to substantiate a claim for damages/statutory infringement compensation.

2. Criminal Action

According to article 180 of the Criminal Code, a criminal offense occurs when a trademark is repeatedly used without consent, or when such use causes substantial damage (currently, at least RUB1,500,000). The amount of damages is determined by the court; it is usually based on the cost of the goods and the volume of unauthorized use of the trademark.

In Russia, legal entities cannot be held liable for a criminal offense. Criminal charges (including in trademark infringement cases) may be lodged against the director(s) of the entity.

Illegal use of trademarks may be punished by a fine of up to RUB200,000, the amount of the infringer's salary or another source of income for an 18-month period, or by mandatory community service for up to 480 hours or correctional labour for up to two years.

If the same act is committed by a group of individuals in a conspiracy or by an organized group, it is considered a more serious criminal offense. Penalties include imprisonment for up to six years with a fine of up to RUB500,000.

3. Administrative Action

a. Sources of Liability

Administrative action can be initiated by the police, customs, the Federal Antimonopoly Service (FAS) or the Agency for Protection of Consumers' Rights, or by the mark owner filing a complaint with one of the above agencies. These authorities will investigate the case, and pass their findings on to the court. The decision of the court of first instance may be appealed in the Court of Appeals and in the Cassation Court.

b. Standards for Infringement

Under article 14.10 of the Administrative Code, an unauthorized use of a trademark or a designation confusingly similar to it for similar goods incurs administrative liability. Administrative sanctions for legal entities include:

- a fine in the amount of triple the cost of the counterfeits, but not less than RUB40,000; and
- confiscation of the counterfeiting goods.

These sanctions are applicable both to individuals and legal entities. The sanctions applied to legal entities are more strict compared than those applied to individuals. If a legal entity repeatedly or grossly infringes IP rights, the court may decide to liquidate it.

Further, administrative liability for infringement of IP rights is provided by Russian antimonopoly legislation. Article 14 of the Russian Competition Law bans acts of unfair competition, including those involving unauthorized use of IP. A trademark owner may file a complaint with Federal Antimonopoly Service of Russia (FAS), a governmental authority supervising competition in the market. He or she is required to demonstrate that:

- the infringing entity is competing with the IP owner;
- the other party is unlawfully using the IP; and
- the infringing activity causes or is likely to cause financial losses or damage to the reputation of the trademark owner (or presents a risk of such negative consequences).

In the event that FAS upholds that the infringer's activities constitute unfair competition, it issues a ruling prohibiting such activities. Pursuant to article 14.33 of the Administrative Code, unfair competition with the illegal use of a third party's trademark by legal entities entails imposition of a fine of up to 15 percent of the infringer's revenue from sales of the infringing goods, but not less than RUB100,000. The FAS procedure usually takes up to six months. An FAS ruling may be appealed in the arbitration court.

4. Customs

a. Requirements for Enforcement

To rely on customs' IP enforcement mechanisms, the trademark owner must file an application requesting recordation of his or her trademarks in the IP Customs Register. The application must be accompanied by a set of documents and data about the trademark owner, his or her trademarks and goods.

b. Enforcement Mechanisms

After the trademarks are registered in the IP Customs Register, any products under a certain trademark imported into Russia by a company that is not in the list of authorized importers of the goods must be detained by the relevant customs office for 10 days. Simultaneously with the detention, customs informs both the importer and the trademark owner, or his or her representative as indicated in the register, of the detention. Within a 10-day period, which can be extended only once, for 10 days, the trademark owner:

- has a right to examine the goods, including the right to obtain samples and pictures; and
- must inform customs whether the goods are counterfeit or not.

If the goods are counterfeit, the trademark owner must initiate legal proceedings against the importer. Failure to initiate legal proceedings within the above-mentioned period will result in the release of the goods.

c. Considerations Relevant to the Enforcement Process

Customs recordal will be efficient only if the trademark owner is ready to promptly react to all notifications by customs. This may be done by appointing a local representative to liaise with various customs contact points on a day-to-day basis, and by having an internal or external expert who may be able to examine suspicious goods on behalf of the trademark owner.

Failure to respond to customs requests related to the detention of allegedly counterfeit goods may result in removal of the trademark from the register and cessation of customs detention activities.

H. United States

1. Civil Action

a. Sources of Liability under Statute and Common Law

In the U.S., IPR owners can file civil lawsuits alleging various causes of action related to counterfeiting. IPR owners should consider asserting all claims that cover their IPR in the specific case. At the federal level, possible causes of action may include trademark infringement, trademark counterfeiting, trademark dilution/tarnishment, trade dress infringement and/or federal unfair competition under the Lanham (Trademark) Act; copyright infringement under the Copyright Act; and design patent infringement under the Patent Act.

Possible state causes of action include IP infringement, passing off and unfair competition under various state statutes. Possible common-law causes of action include trademark infringement, copyright infringement, trade dress infringement, unfair competition, passing off, and misappropriation of IP. IPR owners should also consider alleging violations of the Racketeer Influenced Corrupt Organizations Act (RICO), money laundering and related claims, if applicable.

Depending on the facts, IPR owners may allege direct liability, inducing liability, contributory liability and vicarious liability against persons or entities involved in the infringement/counterfeiting. U.S. courts have held landlords liable for aiding infringement/counterfeiting. U.S courts have not yet held e-commerce service providers (e.g., eBay) liable for aiding infringement/counterfeiting in their roles as intermediaries.

b. Standards for Infringement

Federal and state courts in the U.S. may interpret laws differently depending on the applicable appellate courts' standards and interpretations of those laws. IPR owners must initially establish that the court has subject matter jurisdiction over the IPR owners' claims and personal jurisdiction over all defendants. Generally, the standard for trademark infringement is (i) ownership of a valid trademark; (ii) likelihood of confusion by consumers regarding the parties and their respective goods and services; and (iii) damages. The standard for trade dress infringement is similar. Generally, the standard for copyright infringement is (i) ownership of a valid and registered copyright; (ii) substantial similarity between the copyrighted work and the accused work; and (iii) damages.

The general standard for design patent infringement is (i) ownership of a U.S. design patent; and (ii) similarity in the overall visual appearances of the patented and accused designs, such that an ordinary consumer would be confused or deceived into believing that the accused design was associated with the patented design.

c. Remedies – Civil

In civil actions, IPR owners can seek injunctive relief (temporary restraining/seizure orders (including *ex parte* orders), preliminary injunctions and permanent injunctions). IPR owners can seek monetary damages, which may include statutory damages, actual damages, the defendants' profits, punitive damages, money for corrective advertizing, and the owners' attorneys' fees and costs. IPR owners can seek destruction orders, asset freezing orders and other appropriate orders. IPR owners can seek a court's referral of a civil action to the appropriate government entity that handles criminal actions (U.S. Attorney's Office, etc.). Statutory damages for copyright infringement range from US$750 to US$30,000 per infringed work, and US$200 to US$150,000 per infringed work for willful infringement. Statutory damages for trademark infringement range from US$1,000 to US$200,000 per counterfeit mark per goods/services used, or up to US$2,000,000 per counterfeit mark per goods/services used for willful infringement.

d. Obstacles to Enforcement

For civil lawsuits, IPR owners must initially establish that the court has subject matter jurisdiction over the asserted claims and that the court has personal jurisdiction over all of the defendants. It may be difficult to identify accurate information about defendants, including "John Doe" defendants. It may be difficult to meet the personal jurisdictional requirement for foreign-based defendants. There is an "in rem" jurisdiction under the ACPA. This allows a U.S. court to assert personal jurisdiction over a domain name so that the court can determine if it should remove the domain name from the infringer and/or transfer the domain name to the IPR owner. Infringers/counterfeiters often hide their assets, particularly if the assets are significant. They may place and maintain the assets in offshore accounts. They may place them in family members' or friends' names. Another obstacle IPR owners face is lack of government resources. Some courts are less interested in issuing temporary restraining orders or preliminary injunctions involving counterfeit luxury goods.

2. Criminal Actions

a. Sources of Liability

IPR owners cannot file criminal actions against infringers/counterfeiters. Only the U.S. government or a state government may bring a criminal action against infringers/counterfeiters. U.S. government offices follow various procedures in determining which criminal cases to take. Some U.S. Attorney's Offices accept only criminal cases involving public safety or security (e.g., counterfeit electronics or pharmaceuticals that may endanger U.S. citizens). Other U.S. Attorney's Offices will accept criminal cases involving non-public safety issues (including luxury goods) if there is a sufficient quantity (determined by their office) that justifies proceeding or there is some other reason the office believes the case should be pursued. A criminal action may also be the result of a referral by a court during a civil action, or it may initially be filed as a criminal action. IPR owners can present their evidence of counterfeiting and bases for a criminal action to a U.S. Attorney's Office or state attorney general's office for consideration of filing a criminal action. Federal or state government offices may pursue criminal copyright infringement, trademark infringement, trademark counterfeiting, trafficking in counterfeit goods and similar claims. They may also pursue claims for money laundering, violations of the RICO Act, and other non-IP specific claims.

b. Standards for Infringement

Criminal copyright infringement requires that the infringer acted for the purpose of "a commercial advantage" or "private financial gain". In addition, the prosecutor must prove that the infringer willfully infringed the copyright (possessed the requisite *mens rea*). For criminal trademark infringement, the prosecutor must prove that the infringing mark is spurious; the infringing mark is used in trafficking in goods/services; the infringing mark is identical with or substantially indistinguishable from the genuine mark; the genuine mark is registered on the Principal Register; the genuine mark is in use with goods/service for which the mark was registered; and use of the infringing mark is likely to cause confusion, mistake or deception.

c. Remedies – Criminal

In criminal actions, the U.S. government can seek various penalties against infringers/counterfeiters. For criminal copyright infringement, penalties are determined by the extent of the counterfeiting. If the infringer is convicted of reproducing or distributing 10 or more copies of one or more copyrighted works having a retail value of US$2,500 during a 180-day period, the infringer faces a fine of up to US$250,000, five years' imprisonment, or both, and the action constitutes a felony. For a second conviction, the infringer faces a US$250,000 fine, 10 years' imprisonment or both, and the action also constitutes a felony. If the convicted infringer fails to meet the minimum copies, retail value, or other requirements under the statute, the infringer faces a fine of up to US$100,000 or one year's imprisonment, and the action constitutes a misdemeanor. An individual convicted of international trafficking in counterfeit goods/services faces a fine of up to US$2,000,000 and/or 10 years in prison. A convicted corporation faces a fine of up to US$5,000,000.

d. Obstacles to Enforcement

IPR owners face losing some control of their cases if they pursue criminal actions against the counterfeiters. If the government chooses to proceed with a criminal action, IPR owners relinquish control of the case, and have little to no input in how the action proceeds, but may still provide evidence, etc., to the government handling the case. They may not receive regular updates from the government and may not participate in actual claims pursued, remedies sought or related issues. Another obstacle IPR owners face is a lack of government resources. Some courts are less interested in criminal actions involving counterfeit luxury goods than goods that involve national security or health and safety.

3. Administrative Action

The U.S. does not have direct administrative actions against infringers/counterfeiters. Actions are through the courts.

4. Customs

a. Enforcement Mechanisms

U.S. Customs and Border Protection (CBP) is one of the agencies in the Department of Homeland Security directed to prevent theft of IP in the U.S. It is authorized to search inbound and outbound shipments, regardless of medium. CBP can seize and destroy goods or their packaging that violate copyright, trademark, trade name or trade dress rights.

b. Requirements for Enforcement

CBP requires that IPR owners record their registered trademarks, trade dress and copyrights with it to obtain enforcement by this agency. An IPR owner submits information about the particular registered IP, an image of the IP, and point of contact at the IPR owner, and also pays a small fee. CBP includes the key information in the agency's database for use by field agents inspecting inbound and outbound goods.

c. Considerations Relevant to the Enforcement Process

CBP gives priority consideration to IPR owners who provide training to CBP's staff, including leaving notebooks or manuals with relevant information and counterfeit indicia. CBP is also more receptive to enforcing IPR owners' rights when they respond promptly to CBP's inquiries about alleged counterfeit goods, and provide regular updates about new infringers, locations, and other relevant information. IPR owners may inspect alleged counterfeit goods upon post Another obstacle IPR owners face is a lack of government resources. Some courts appear less willing/interested in issuing temporary restraining orders or preliminary injunctions involving counterfeit luxury goods.

I. Canada

1. Civil Action

a. Sources of Liability

i. Copyright

Please refer to section 2.1(b) in Part I for an explanation of the relevant statutory provisions relating to copyright infringement liability.

ii. Trademark

Please refer to section 2.1(c) in Part I for an explanation of the relevant statutory provisions addressing trademark infringement liability.

In addition to the statutory protections offered by the Trademarks Act, trademark owners are also protected by the common-law tort of passing off. The tort of passing off protects symbols of source and quality in the form of trade names, trademarks and other related indicia.[29] Notably, however, common law passing off protects the reputation or goodwill associated with a trademark, rather than the trademark itself. It also protects against trade misrepresentations including "false or misleading trade descriptions in association with wares or services and substitution of wares or services for those ordered or requested".[30] A company need not be carrying on business in Canada for it to have protectable goodwill in Canada, nor does it have to prove that its trademark has become well known in Canada within the meaning of section 5 of the Act.

iii. Industrial Design

A "design" is any feature of shape, configuration, pattern or ornament, and any combination of these features, that, in a finished article, appeal to and are judged solely by the eye.[31] Designs are registered in association with specifically identified articles.

The registration of an industrial design under section 9 of the Industrial Design Act establishes a party's exclusive right to an industrial design. It is an infringement under section

[29] *Kirkbi AG v. Ritvik Holdings Inc.*, 2005 SCC 65 (SCC).
[30] *Fox on Trade-marks and Unfair Competition*, pp. 4-3 and 4-4.
[31] Industrial Design Act, RSC 1985, c I-9, s. 2 [Industrial Design Act].

11(1)(a) to make, import for commercial purposes, sell, rent, or offer or expose for sale or rent a registered design, or a design that does not differ substantially from a registered one, without the proprietor's written consent.[32]

The proprietor or exclusive licensee of the design can bring an action for damages under section 15 of the Act against any person who applies or imitates a design with knowledge that the proprietor has not consented. The action is only maintainable only in respect of the person who applies the design to the article, not a person who sells it.[33]

Of note, the Canadian Industrial Design Act is also in the process of being amended. On 17 December 2014, Bill C-43, a bill that amends the Canadian Patent Act and Industrial Design Act to try to harmonize Canada's IP regime with international practices, received Royal Assent. For example, the bill will make the Industrial Design Act consistent with the Geneva Act of the Hague Agreement Concerning the International Registration of Industrial Designs, and give the Governor in Council the authority to make regulations for carrying it into effect.

b. Standards of Infringement

i. Copyright

As explained in Part I, section 27 of the Copyright Act sets out the general definition of infringement under the Act. Direct or primary infringement under subsection 27(1) does not require that the defendant have an intention to infringe or any knowledge that infringement has occurred.[34] Furthermore, in cases of indirect infringement or secondary infringement involving importation, it is irrelevant whether the importer knew or should have known that the imported work or good infringed copyright.[35]

A copyright owner must establish two essential elements in order to succeed in a copyright action. First, there must be sufficient similarity between the works in question, such that the allegedly infringing work could be considered a copy of the protected work. Second, the owner must prove that the copyrighted work was the source from which the allegedly infringing work was derived.[36] Furthermore, the Supreme Court of Canada has held that the concept of "reproduction" involves the multiplication of copies, such that the defendant has created something that did not previously exist. Where, for instance, the image on a poster is transferred to canvas, leaving the original poster completely blank, there has been no infringement.[37]

Infringement can only occur where there has been a production or reproduction of a work or any substantial part thereof. Substantial similarity between a copyrighted work and an allegedly infringing work may be *prima facie* evidence of reproduction, but such presumption may be rebutted by evidence that the defendant has taken steps to prevent such copying from occurring.[38] Factors to be considered when determining whether a substantial part of a work has been taken include:

[32] *Ibid* at s. 11.
[33] *Société anonyme des cuirs Meillon c Brumer*, [1976] JQ no 112 (CA).
[34] *Compo Co. v. Blue Crest Music Inc.* (1979), [1980] 1 SCR 357 (SCC).
[35] Copyright Act, s. 27(3).
[36] *Philip Morris Products S.A. v. Marlboro Canada Ltd.*, 2010 FC 1099 (Fed. Ct.), reversed on other grounds, at para. 315.
[37] *Galerie d'art du Petit Champlain Inc. v. Théberge*, 17 CPR (4th) 161 (SCC).
[38] *Preston v. 20th Century Fox Canada Ltd*. (1990), 33 CPR (3d) 242 (Fed. Ct.), aff'd (1994), 53 CPR (3d) 407 (Fed. CA).

- the quality and quantity of the material taken;
- the extent of adverse economic impact on the owner;
- whether the material taken is the proper subject matter of copyright;
- the purpose for which the material is taken; and,
- whether the material taken is used in the same or a similar fashion as the owner's use.[39]

For a work, or other subject matter in which copyright subsists, to fall within the scope of secondary infringement, three elements must generally be proven.[40] First, the owner must prove that primary infringement of copyright has taken place. (The exception to this requirement is subsection 27(2)(e), which requires only that an imported work "would infringe copyright if it had been made in Canada by the person who made it". As such, paragraph 27(2)(e) substitutes hypothetical infringement for actual infringement of copyright.) Second, the secondary infringer must know or ought to have known that he or she was dealing with a product of infringement. In proving the second element of the test, the copyright owner need only establish the existence of facts that would suggest to a reasonable person that a breach of copyright was being committed or that the defendant engaged in willful blindness.[41] Finally, the infringer must engage in conduct enumerated in subsection 27(2).

ii. Trademark

An action in passing off requires a trademark owner to establish three things. First, the mark owner must establish that it has claim to goodwill or reputation. Second, there must be an actionable misrepresentation. In the context of passing off, such misrepresentation may be willful, or may simply be attributable to negligent or careless misrepresentation.[42] An action in passing off requires that the defendant make use of the same or confusingly similar trading indicia, such that the relevant market would confuse the defendant's wares, services or business as originating from the mark owner. Finally, a mark owner must demonstrate that actual damage has occurred, or that a probability of damage exists. However, it is not necessary for the mark owner to adduce evidence of injury to his or her reputation or goodwill.[43]

As explained in Part I, section 19 of the Trademarks Act encompasses the unauthorized use of an owner's exact mark in association with identical wares and services, whereas section 20 is engaged where a defendant's mark is confusingly similar to that of a mark owner. In an infringement action under section 19:

> the plaintiff must only prove entitlement to bring the action as the registered owner, owner or licensee … and that the defendant is using the registered mark, as a trademark, without authorization in association with any of the wares and services for which the mark is registered. Nothing else need be proved in such an action to enjoin the defendant's use of the mark anywhere in Canada.[44]

[39] *Fox on Canadian Law of Copyright and Industrial Designs*, p. 21-16.1.
[40] *CCH Canada Ltd. v. Law Society of Upper Canada* (2004), 30 CPR (4th) 1 (SCC).
[41] *Microsoft Corp. v. 9038-3746 Quebec Inc*., 2006 FC 1509 (Fed. Ct.).
[42] *Kirkbi AG v. Ritvik Holdings Inc.*, 2005 SCC 65 (SCC) at para. 60.
[43] *Nissan Canada Inc. v. BMC Canada Inc*., 2007 FCA 255 (Fed. CA) at paras. 35–37.
[44] *Fox on Canadian Law of Trade-marks and Unfair Competition*, p. 7-17.

To sustain an infringement action under section 20:

> a plaintiff must establish that: (1) it is entitled to commence the action with respect to the registered trademark in issue; and that (2) a sale, distribution or advertisement of any wares or services has occurred; (3) in association with a confusing trademark or trade-name; (4) by a person not entitled under the *Trademarks Act* to the use of the registered trademark; (5) as a trademark.[45]

With regard to an action for the depreciation of goodwill under section 22 of the Trademarks Act, the Supreme Court of Canada has set out four requirements.[46] First, the plaintiff must show that its *registered* trademark was used by the defendant in connection with wares or services, regardless of whether such wares or services were in competition with those of the plaintiff. Second, the plaintiff must prove that the trademark is sufficiently well known as to have significant goodwill attached to it. Third, the mark must have been used in a manner likely to have an effect on goodwill. Finally, the likely effect must be a deprecation of the value of the mark's goodwill. The Supreme Court has held that an allegedly infringing mark comprising only the distinguishing features of a registered trademark may be sufficient to base an action for depreciation of goodwill.[47]

iii. Industrial Design

To establish infringement under section 11(1) of the Industrial Design Act, a court will look at whether there are substantial differences between the impugned design and a registered one, including the extent to which the registered design differs from a previously published design.[48] Particularly, the Act dictates that a court will first consider whether the defendant engaged in one of the activities of making, importing for the purposes of trade or business, selling or renting, or offering or exposing for sale or rent. Second, it will consider whether the allegedly infringing article is an article in respect of which a design has been registered. Last, a court will look at whether the design, or a design not differing substantially from it, has been applied to the allegedly infringing article.

While infringement is established on facts,[49] it is also to be decided by the eye.[50] The whole of the industrial design must be considered in determining the number of apparent differences between the items, and not just its individual components.[51] In order to determine if the totality of a design has been used, courts generally ask three questions:

- would one design be confused with the other?
- would the defendant's design have any existence if it were not for the plaintiff's design?; and
- is the defendant's design closest to that of the plaintiff compared to any prior user's?[52]

[45] *Fox on Canadian Law of Trade-marks and Unfair Competition*, p. 7-19.
[46] *Veuve Clicquot Ponsardin v. Boutiques Cliquot*, 2006 SCC 23 (SCC) at para. 46.
[47] *Veuve Clicquot Ponsardin v. Boutiques Cliquot*, 2006 SCC 23 (SCC) at para. 48.
[48] Industrial Design Act, *supra* at ss 11(2).
[49] *Clatworthy & Son Ltd. v. Dale Display Fixtures Ltd*, [1929] SCR 429 at 434 (SCC).
[50] *Algonquin Mercantile Corp. v. Dart Industries Canada Ltd*, [1984] FCJ No 500 (CA).
[51] *Industries LUMIO (Canada) Inc v. Dusablon*, [2007] JQ no 2279 (Sup Ct).
[52] *Mainetti SpA v. ERA Display Co*, [1984] FCJ No 230 (Fed CA).

In determining whether there has been infringement, courts will use the viewpoint of an informed consumer.[53] However, expert evidence may assist to highlight similarities and differences between the items and to inform the court as to what is common to the trade.[54]

Unlike the Copyright Act, the Industrial Designs Act does not distinguish between direct and secondary infringement. Thus, the acts of parties engaged in unauthorized dealing with infringing articles will also be considered when examining infringement.[55] It is also not necessary to demonstrate intention to infringe; if an infringement occurs, a good faith intention not to infringe will not serve as a defense.[56] On the other hand, the absence of knowledge and the absence of reasonable grounds for suspecting that the design was registered may serve as a defense.[57]

c. Remedies

i. Copyright

Under subsection 34(1) of the Copyright Act, a copyright owner who has successfully proven infringement by a defendant may enjoy any of a number of remedies, including an injunction, declaratory relief, damages or an accounting of profits, recovery of the infringing works and costs.

A successful plaintiff is *prima facie* entitled to a permanent injunction,[58] although the defendant may resist the injunction on the basis that the infringement is not substantial. As noted in *Fox on Canadian Law of Trademarks and Unfair Competition*, "[w]here the infringement of the defendant is an isolated event, not continued or likely to be continued or repeated, it is not usual to grant an injunction".[59]

Damages awards are generally assessed on the basis of injury done to the plaintiff, such that the measure of damages in the context of copyright infringement is equal to "the depreciation in the value of the copyright as a chose in action", with the caveat that "the damages must flow directly from the acts complained of and they must not be too remote".[60] Where the parties are in competition with one another, a court may order that damages be paid, over and above direct financial loss, in order to compensate for harm that may have been caused to the plaintiff's business.[61] In addition to a damages award, a successful plaintiff is entitled to receive "such part of the profits that the infringer has made from the infringement and that were not taken into account in calculating the damages as the court considers just".[62] Such disgorgement may be available even where a plaintiff is unable to prove the existence of damage.[63]

Courts have also awarded punitive damages after considering factors such as whether the misconduct was planned and deliberate, the defendant's motive, whether the infringement persisted over a lengthy period of time, whether the defendant attempted to conceal his or her misconduct, the defendant's awareness that his or her conduct was wrong, whether the defendant

[53] *Bodum USA Inc v. Trudeau Corp* (1889) Inc, [2012] FCJ No 1310 (Fed TD).
[54] *Fox on Canadian Law of Copyright and Industrial Designs*, p 31:12.
[55] *Fox on Canadian Law of Copyright and Industrial Designs*, ch 21.
[56] *Fox on Canadian Law of Copyright and Industrial Designs*, p 31:11.
[57] Industrial Design Act, *supra* at s. 17.
[58] *Underwriters' Survey Bureau Ltd. v. Massie & Renwick Ltd.*, [1937] SCR 265 (SCC) at 269.
[59] *Fox on Canadian Law of Trademarks and Unfair Competition*, p. 24-63.
[60] *Fox on Canadian Law of Trademarks and Unfair Competition*, pp. 24-70 - 24-71.
[61] *Fox on Canadian Law of Trademarks and Unfair Competition*, p. 24-72.1.
[62] Copyright Act, s. 35.
[63] *Euro-Excellence Inc. v. Kraft Canada Inc.*, 2007 SCC 37 (SCC).

profited from his or her actions, and whether the interest violated by the misconduct was known to be deeply personal to the plaintiff or a thing that was irreplaceable.[64]

Finally, a copyright owner may elect, under section 38.1, for an award of statutory damages in place of damages and profits under subsection 35(1). The prescribed amounts are as follows: (1) between C$500 and C$20,000, if the infringements are for commercial purposes; and (b) between C$100 and C$5,000, if the infringements are for non-commercial purposes. Subsections 38.1(3) and 38.1(5) set out the factors to be considered in determining the quantum of statutory damages, including the number of works in a single medium; proportionality between the infringement and the total award; the bad or good faith of the defendant; the conduct of the parties before and during the proceedings; and the need to deter other infringements of the copyright in question. In determining the quantum of statutory damages for infringements in the context of non-commercial purposes, subsection 38.1(5) adds the following factors: the need for an award to be proportionate, in consideration of the hardship that may be caused to the defendant; whether the infringement was for private purposes or not; and the impact of the infringements on the plaintiff.

With regard to the recovery of infringing works, a copyright owner may, under section 38 of the Copyright Act, recover possession of all infringing copies of the work and of all plates used or intended to be used for the production of such works, as though the copyright owner were the original owner of the infringing copies and plates. Similarly, a defendant may be ordered, under section 34 of the Copyright Act, to deliver up its infringing works to the plaintiff as an ancillary order to an injunction. It should be noted that, although a successful plaintiff has a *prima facie* right to an order requiring the defendant to deliver up its works, the grant remains discretionary. Courts may refuse to grant such an order, or may craft the order so as to require the delivery of infringing *parts*, where such parts may be severed from the remainder of the defendant's works.[65]

ii. Trademark

Section 53.2 of the Trademarks Act allows courts wide discretion in crafting an appropriate civil remedy for infringement, allowing for "any order that it considers appropriate in the circumstances". Such orders may include, but are not limited to, temporary or permanent injunctions; the recovery of damages or profits; and the destruction, exportation or other disposition of any offending wares, packages, labels and advertizing material and of any dies used in connection therewith.

Although a permanent injunction is a discretionary order, courts will "almost invariably grant a permanent injunction to a plaintiff who has established at trial that the legal rights in issue have been improperly invaded".[66] In granting such an injunction, however, courts must take care to avoid issuing those that encompass permissible activity alongside prohibited conduct.[67] To ensure that such orders are complied with, courts will often require defendants to destroy, deliver up or export the infringing works. In addition to accompanying permanent injunctions, the Federal Court of Appeal has held that destruction or delivery orders may be necessary before the final

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[64] *Microsoft Corp. v. 9038-3746 Quebec Inc.* at para. 118; *Louis Vuitton Malletier S.A. v. Singga Enterprises (Canada) Inc.*, 2011 FC 776 (Fed. Ct.) at para. 166.

[65] *Apple Computer Inc. v. Mackintosh Computers Ltd.*, [1987] 1 FC 173 (Fed. TD), additional reasons at (1987), 12 FTA 287, varied (1987) 16 CIPR 15 (Fed. CA), aff'd (1990), 110 NR 66 (SCC).

[66] *Fox on Canadian Law of Trade-marks and Unfair Competition*, p. 13-18.

[67] *Target Event Production Ltd. v. Cheung*, 2010 FCA 255 (Fed. CA) at para. 33.

determination of an action on its merits, where a defendant has breached an interlocutory injunction and there is sufficient evidence that the defendant is unlikely to comply with a future interlocutory order.[68]

As an alternative to an order for destruction or delivery up of infringing works, a plaintiff may request an accounting of profits. A plaintiff is not entitled to enjoy both remedies; rather, the plaintiff must elect between the remedies before the court grants an order regarding the assessment of damages.[69] Where proof of damages and profits has been made impractical by the defendant's activities, the Federal Court has fashioned a "nominal' award for infringing activity. In 1997, a scale was created as follows: C$3,000 per infringing activity where the defendants were operating from temporary premises such as flea markets, C$6,000 where the defendants were operating from conventional retail premises, and C$24,000 where the defendants were the manufacturers and distributors of counterfeit goods.[70] These amounts were recalculated over subsequent years to account for inflation, with the exact adjusted amount depending on the year(s) in which the infringing activity took place. In 2011, the nominal damage award of C$24,000 for manufacturers and distributors of counterfeit goods was increased to a base amount of C$30,000 per infringing activity.[71]

iii. Industrial Designs

In addition to the recovery of damages or profits, a court may order punitive damages, delivery up, accounting for profits, disposal of any infringing article or kit, or may grant relief through an injunction.[72] While not a defense, lack of intention to infringe a design may be relevant in assessing damages.

The measure of damages to be awarded to the plaintiff is the actual loss suffered as a result of the defendant's acts.[73] The usual measure of damages is the loss of profit that the plaintiff would have made had he or she sold the articles instead of the infringer.[74] Given the nature of industrial design rights, damages will frequently be an adequate remedy and interlocutory injunctions will seldom be granted.[75] A plaintiff should, however, be able to obtain an interlocutory injunction where he or she can satisfy the test for an injunction, and where the court's failure to grant the remedy will cause the plaintiff irreparable harm.[76]

d. Obstacles to Enforcement

In 2007, the Canadian Anti-Counterfeiting Network reported a number of problems arising from attempts to prevent counterfeiting through civil actions. First, they noted that infringers are often "impossible to identify, properly serve, or enforce orders against" and "[a]lthough an IP rights holder *may* be able to obtain a 'John Doe' civil seizure (Anton Piller) order, the costs of

[68] *Thurston Hayes Developments v. Horn Abbot Ltd*. (1985), 5 CPR (3d) 124 (Fed. CA) at 126.
[69] *Beloit Canada Ltée v. Valmey Oy* (1987), 16 CPR (3d) 92 (Fed. CA).
[70] *Louis Vuitton Malletier S.A. v. Singga Enterprises*, 2011 FC 776 (Fed. Ct.) at para. 129.
[71] *Louis Vuitton Malletier S.A. v. Singga Enterprises*, 2011 FC 776 (Fed. Ct.) at para. 136.
[72] *Ibid*.
[73] *Lightning Fastener Co. v Colonial Fastener Co Ltd* (1935), [1936] Ex CR 1 (Can Ex Ct).
[74] *Consolidated Wafer Co v. International Cone Co* (1926), 59 OLR 205 (Ont Sup Ct).
[75] *Zivin v. Gilbro Ltd* (1988), 19 CPR (3d) 516 (Fed TD).
[76] *Fox on Canadian Law of Copyright and Industrial Designs*, p 31:12.

execution remain high, and neither seizures nor civil penalties have any deterrent effect" because civil remedies are compensatory in nature.[77] Second, even where rights holders are able to prove an infringement, it becomes exceedingly difficult to estimate the quantum of damages because counterfeiting is often a clandestine enterprise. Although a scale of nominal damages has been set out by the Federal Court, the Canadian Anti-Counterfeiting Network asserts that the awards are "too small to deter counterfeiters, often are not collected and, even when issued with an injunction, do not prevent recidivism".[78] Finally, because counterfeiters often target a range of IP rights holders, copyright and trademark owners may be forced to coordinate their civil enforcement actions in order to respond effectively against a particular counterfeiter, which is likely to be difficult in practice.[79]

For these reasons, the Canadian Anti-Counterfeiting Network concluded that *criminal* enforcement of IP rights should be the preferred method for protecting rights holders, although such action is accompanied by unique problems, as discussed below.

2. Criminal Action

a. Sources of Liability

i. Copyright Act

Section 42 of the Copyright Act sets out the criminal provisions relating to copyright infringement. Subsection 42(1) provides that it is an offense to knowingly sell, rent, offer for sale or rental, distribute, exhibit or import for sale or rental any infringing copy of a work. Subsection 42(2) sets out the criminal provisions relating to the knowing manufacture or possession of a plate that is designed for adapted for the purpose of infringing copyright.

ii. Criminal Code

Section 380 of the Criminal Code sets out the penalties for engaging in fraud, which may be applied in the context of counterfeit goods, trademark infringement and copyright infringement.

The Supreme Court of Canada has found that the taking of confidential information does not amount to "property" for the purposes of the Criminal Code, notwithstanding that the property was the subject of copyright.[80] As such, copyright cannot be the object of theft under the Criminal Code.

The Criminal Code also contains a number of offenses relating specifically to trademarks. Sections 406 and 407 set out offenses relating to the forgery of trademarks, and section 409 addresses instruments used in forging trademarks. However, subsection 409(2) provides a defense where an individual has acted in good faith in the ordinary course of business or employment. Section 408 prohibits the passing off of wares or services, which may be of particular interest to

[77] The Canadian Anti-Counterfeiting Network, "Report on Counterfeiting and Piracy in Canada: A Roadmap for Change", March 2007 at p. 17.
[78] The Canadian Anti-Counterfeiting Network, "Report on Counterfeiting and Piracy in Canada: A Roadmap for Change", March 2007 at p. 18.
[79] The Canadian Anti-Counterfeiting Network, "Report on Counterfeiting and Piracy in Canada: A Roadmap for Change", March 2007 at p. 19.
[80] *R. v. Stewart* (1988), 41 CCC (3d) 481 (SCC).

owners of trademarks used in association with the sale of luxury goods. Under section 410, it is an offense to deface, conceal or remove a trademark or trade name, or to fill any container bearing a trademark or trade name with a liquid for the purpose of sale or traffic. Finally, section 411 prohibits the sale or advertisement of goods that are used, reconditioned or remade, which bear a trademark or trade name, if full disclosure has not been made that the goods are not in their original condition.

iii. Trademark Acts

The Trademarks Act does not contain provisions relating to criminal liability for trademark infringement. However, Bill C-8 will expand the act to include such provisions. A discussion of the proposed changes can be found in Part I, Section 2.1(c).

iv. Industrial Design

The Industrial Designs Act does not contain provisions relating to criminal liability for industrial design infringement.

b. Standards for Infringement

i. Copyright Act

Under Canadian law, the use of the term "knowingly" in a criminal statute relates to all parts of the *actus reus* of an offense.[81] As an alternative to proving an accused's knowledge, a prosecutor may satisfy the intentional element of a criminal offense by establishing that the accused acted recklessly or with willful blindness.[82] Recklessness is established when it can be proven that the accused had knowledge of a danger or risk and proceeded with a particular course of conduct, without care as to whether the consequences would ensue.[83] Willful blindness, on the other hand, involves an accused whose suspicions have been aroused to the possibility of particular consequences but has failed to make further inquiries because he or she wishes to remain in ignorance.[84]

With regard to the *actus reus* of the copyright offenses, an "infringing copy' of a work is defined in the Copyright Act as including "any copy, including any colourable imitation, made or dealt with in contravention of the Act". As noted in *Fox on Canadian Law of Copyright and Industrial Designs*, the definition of a "plate" under section 42(2) of the Copyright Act has been interpreted to include "an acetate matrix used to press records, a ROM chip used to produce a hexadecimal version of a computer program, a machine used to reproduce a tape recording of a song, and a copy of a cinematograph film used for the purpose of making an infringing copy".[85]

[81] *R. v. Jorgensen*, (1995), 129 DLR (4th) 510 (SCC) at para. 65.
[82] *R. v. Sault Ste. Marie (City)*, [1978] 2 SCR 1299 (SCC) at 1309-1310.
[83] *R. v. Théroux*, [1993] 2 SCR 5 (SCC) at 20.
[84] *R. v. Jorgenson*, [1995] 4 SCR 55 (SCC) at paras. 103-104.
[85] *Fox on Canadian Law of Copyright and Industrial Designs*, p. 25-9.

ii. Criminal Code

For a prosecutor to prove fraud beyond a reasonable doubt, he or she must establish two elements, "dishonesty" and "deprivation". However, the concept of deprivation does not require an actual economic loss to the complainant; rather, it is satisfied on proof of detriment, prejudice or risk of prejudice to the complainant's economic interests.[86]

As noted in *Fox on Canadian Law on Trademarks and Unfair Competition*, for an accused to be convicted of forging trademarks under section 406 of the Criminal Code, three elements must be proven: (i) the existence of a trademark; (ii) the lack of consent; and (iii) the making or reproduction of the mark or a mark that is calculated to deceive the public.[87] Where an accused's conduct falls within the ambit of section 406, it will have also satisfied the *actus reus* required to be proven under section 407 of the Criminal Code. To satisfy the mental element of forgery under section 407, it must be proven that the accused had the "intent to deceive or defraud the public or any person".

Passing off by substituting wares, which is prohibited under subsection 408(a) of the Criminal Code, requires a prosecutor to prove that the accused had an intention to deceive or defraud the public by passing off his or her wares or services as the wares and services of another, where the latter are ordered or requested. This final element of the offense, namely, the substitution of wares or services *ordered or requested*, appears to require a direct misrepresentation between the accused and the ordering or requesting party.

Subsection 408(b) of the Criminal Code, which prohibits the use of any false description in association with wares or services, also requires the prosecutor to establish that the accused had an intention to deceive or defraud the public or any particular person. To constitute an offense, the description must relate to any of the following, in connection with wares or services: the kind, quality, quantity, or composition; the geographical origin; or the mode of manufacture, production or performance. Furthermore, the description must be false "in a material respect", to constitute an offense, although such term is not defined in the Criminal Code. It is often difficult to determine whether a particular false statement is also "false in a material respect". There do not appear to be any cases interpreting the meaning of "false in a material respect" in the context of counterfeit goods.

The *actus reus* for the offense of defacing trademarks and misusing trademarked bottles is set out in section 410. The required *mens rea* is an intention to deceive or defraud, as explained above.

Finally, section 411, which prohibits the sale of refurbished items without full disclosure of their history, requires the prosecutor to prove not only that the goods are sold or advertized for sale, but that the accused had the intention to sell or offer to sell the items and an intention not to disclose their history. Although the provision does not specify the need to prove an intention to deceive or defraud, such intention may be encompassed in the intention not to make full disclosure.

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[86] *R. v. Olan* (1978), 41 CCC (2d) 145 (SCC) at paras. 11-13.
[87] *Fox on Canadian Law of Trade-marks and Unfair Competition*, p. 16-5.

c. Penalties

i. Copyright Act

An individual may be prosecuted summarily or by indictment. On summary conviction, an individual who is found to have infringed copyright in a work or other subject matter in which copyright exists is liable for a fine of up to C$25,000, up to six months' imprisonment, or both. On conviction on indictment, the individual is liable for a fine of up to C$1,000,000, up to five years' imprisonment, or both. The same penalties apply if the individual is convicted of making or possessing plates whose purpose is to infringe copyright.

Subsection 42(3) also allows a court to order that all infringing copies or all plates in the possession of the offender be destroyed, delivered up to the copyright owner, or otherwise disposed of as the court sees fit.

ii. Criminal Code

Where the value of the subject matter of a fraud offense exceeds C$5,000, the accused is liable to a term of up to 14 years' imprisonment. Where the value is less than C$5,000, the accused is liable to a term of up to two years' imprisonment, if prosecuted by indictment. If prosecuted summarily, the accused is liable to a term of up to six months' imprisonment, a fine of up to C$5,000, or both. Under subsection 380(1.1) of the Criminal Code, where a person is prosecuted on indictment for a fraud whose value exceeds C$1,000,000, there is a minimum punishment of two years' imprisonment.

If convicted of any of the offenses relating to forgery of trademarks and trade descriptions, an accused is liable to a term of up to two years' imprisonment, if convicted on indictment. If prosecuted summarily, the accused may be liable to a term of up to six months' imprisonment, a fine of C$5,000, or both. Finally, pursuant to subsection 412(2) of the Criminal Code, the court may order the forfeiture of "anything by means of or in relation to which a person commits [the relevant offense]".

d. Obstacles to Enforcement

At present, the Trademarks Act and the Industrial Design Act do not contain their own criminal provisions relating to infringement. Such offenses must be prosecuted under the Criminal Code. The trademark and trade name-related offenses in the Criminal Code apply most clearly in situations where an infringer intends to sell a counterfeit product to a purchaser who mistakenly believes the goods to be authentic. It does not appear to apply to situations in which infringers are openly selling counterfeit products without the knowledge that they are counterfeit. A number of Canadian commentators have asserted that the Trademarks Act should be amended to make clear that importing and exporting of counterfeit goods are criminal offenses. Bill C-8 is expected to implement these changes to the act.

In addition, although the Criminal Code contains provisions relating to the possession of proceeds of crime, these provisions explicitly do not apply to indictable offenses under the Copyright Act. By excluding the Copyright Act, Parliament has removed an avenue that should arguably be made available for prosecutors to pursue in combating counterfeiting and piracy.

Finally, observers within the Canadian IP sphere have asserted that there is “inadequate enforcement of IP rights at both the police and prosecutorial levels”, which is attributed to inadequate police resources, inadequate prosecutorial services, and a lack of training or expertise in the prosecution of criminal IP offenses.[88] The limited number of criminal prosecutions related to counterfeiting may be due to these factors, as well as to “disproportionately small fines … [that] do not even cover the cost of investigation, seizure, storage, and destruction of the counterfeit material”.[89]

3. Customs

a. Enforcement Mechanisms and Requirements for Enforcement

i. Copyright Act

Section 44 of the Copyright Act provides that copies made outside of Canada of any work in which copyright subsists that, if made in Canada, would infringe copyright shall not be imported. Sections 44.1 to 44.4 set out the court’s powers for preventing the importing of copyrighted works, including orders for interim custody by customs officers. An order under subsection 44.1(3), directing the Minister of National Revenue to detain a potentially infringing work, may be made where the court is satisfied of three facts:[90] first, that copies of the work are about to be imported into Canada or have been imported into Canada but have not yet been released; second, that copies were made without the consent of the copyright owner or the copies were made outside of Canada; and, finally, that the copies would infringe copyright if they were made in Canada by the importer and the importer knows or should have known this fact.

The application for a court order directing detention of the works in question may be made through an action or otherwise, either on notice or *ex parte* with regard to the importer, although it must always be made on notice to the minister.[91] Before an order is granted, the applicant may be required to furnish security in an amount fixed by the court, which may later be used to compensate for any damages or charges arising out of the order.[92] If, after two weeks of such detention, the applicant does not notify the minister that it has commenced a proceeding for a final determination by a court of the legality of the works’ import or distribution, the works may be released without further notice to the applicant.[93] If an action is commenced and the court considers it appropriate, the detained copies of the work may be destroyed or delivered up to the plaintiff.[94]

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[88] The Canadian Anti-Counterfeiting Network, “Report on Counterfeiting and Piracy in Canada: A Roadmap for Change”, March 2007 at p. 11.
[89] The Canadian Anti-Counterfeiting Network, “Report on Counterfeiting and Piracy in Canada: A Roadmap for Change”, March 2007 at p. 13.
[90] Copyright Act, s. 44.1(2).
[91] Copyright Act, s. 44.1(4).
[92] Copyright Act, s. 44.1(5).
[93] Copyright Act, s. 44.1(8).
[94] Copyright Act, s. 44.1(9).

ii. Trademarks Act

An interested person may apply to a court for a determination that a registered trademark or trade name has been imported into Canada or is about to be distributed in a manner that constitutes trademark infringement. In such a situation, the court may make an order for the interim custody of the wares by the Canada Border Services Agency, pending a determination of the legality of their import or distribution.[95] In addition, an applicant may seek a court order directing the Minister of National Revenue to take reasonable measures to detain wares that are about to be imported into Canada or that have been imported into Canada but have not yet been released.[96] Whether the applicant seeks an order for interim custody under subsection 53(1) or an order directing the minister to detain wares under subsection 53.1(1), the applicant may be required to furnish security in an amount fixed by the court, which may later be used to compensate for any damages or charges arising out of the order.

If the applicant seeks an order under subsection 53.1(1), the wares will be held for two weeks unless the applicant notifies the Minister of National Revenue that he or she has commenced an action for a final determination by a court of the legality of the import or distribution of the wares being held. If such notice is not provided within the allotted time, the minister may release the wares without further notice to the applicant.[97] If an application is commenced and the court is satisfied that the import or distribution of the goods would be contrary to the Trademarks Act, the court may make any order that it considers appropriate, including ordering that the wares be destroyed or exported, or that they be delivered to the plaintiff as the plaintiff's property.[98]

b. Considerations Relevant to the Enforcement Process

In a June 2012 report, the Canadian Intellectual Property Council summarized the issues relating to customs-based methods of combating counterfeit or otherwise infringing goods as follows:

> It is clear that borders can be used effectively by rights holders to enforce their IP rights. In Canada the effectiveness of border enforcement is significantly impaired by the inability of border officials to seize and hold counterfeit products at their own initiative. Unless the [Royal Canadian Mounted Police] becomes involved and provides specific information about a shipment, [Canada Border Services Agency] agents are unable to act when encountering commercial shipments of counterfeit goods. What Canada needs at its borders is legislation that adequately addresses the realities of IPR theft and empowers our law enforcement officials to protect legitimate channels of trade. To achieve this, the Canadian government must grant CBSA agents *ex officio* authority to search, detain, seize and destroy counterfeit and pirated goods.[99]
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> …

[95] Trademarks Act, s. 53(1).
[96] Trademarks Act, s. 53.1(1).
[97] Trademarks Act, s. 53.1(6).
[98] Trademarks Act, s. 53.1(7).
[99] Canadian Intellectual Property Council, "Counterfeiting in the Canadian Market", June 2012 at p. 27.

Furthermore, under the Customs Act, it is not illegal to import counterfeit goods. The Customs Act must be modified to clearly state that the import and export of counterfeit and pirated goods is a criminal offense, in respect of which border officials can take independent action.[100]

At present, a court order is required before customs agents will move to detain or seize allegedly counterfeit goods. However, as discussed in Part 1, Section 2.1, Bill C-8 creates a process by which copyright and trademark owners could request assistance from CBSA to detain potentially infringing goods.

J. Mexico

1. Civil Action

a. Sources of Liability under Statute and Common Law

In Mexico, there is no civil action that can be initiated based on IP rights to proceed with enforcement in the offline landscape.

b. Standards for Infringement

This is not applicable in Mexico.

2. Criminal Action

Criminal action can only be taken in those cases where a trademark is reproduced identically or regarding copyright. Criminal action is not available for similar marks or patents, utility models or industrial designs. It is the most vehement action available, since it potentially imposes imprisonment for two to six years.

To initiate criminal action, it is necessary to publish a notice in one of Mexico's main newspapers, to inform the public that the rights holder is the owner of certain IP right in Mexico. This is a formal requirement that needs to be met in order to request an injunction; a damages claim also needs to be filed later on. An alternative to such publication is the insertion of proper indications of the protection of the IP rights of the products, e.g., ®, M.R., patent pending or patent, in the original products.

3. Administrative Action

An administrative infringement action is a proceeding that is filed with the Mexican Patent and Trademark Office, the agency that will be in charge of the prosecution of the case. During this kind of proceeding, it is possible to seize an infringer's merchandise during a visit of inspection. If the affected party requests the seizure of goods, it will be necessary to offer a bond to guarantee the possible damage that may be caused to the defendant. The bond amount will be determined by the Trademark Office. Likewise, the defendant is entitled to avoid the seizure by offering a counter-bond.

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[100] Canadian Intellectual Property Council, "Counterfeiting in the Canadian Market", June 2012 at p. 28.

a. Sources of Liability

The Industrial Property Law empowers rights holders to initiate infringement actions against alleged infringers before the Mexican Patent and Trademark Office, which will be in charge of the prosecution of the infringement actions. The Trademark Office is entitled to set infringement fines as a consequence of unlawful activities.

The Mexican Industrial Property Law sets forth the following remedies for dealing with infringement:

- visits of inspection;
- impoundment of infringing articles and machinery;
- monetary fines;
- temporary and/or final closures;
- administrative arrest; and
- provisional measures;
  - ordering the withdrawal from circulation or preventing circulation of goods that infringe IP rights;
  - prohibiting the marketing or use of products covered by IP rights; and
  - ordering the alleged infringer or third parties to suspend or stop the actions that constitute a violation of IP rights.

The decision as to which of these remedies is imposed will depend on the Mexican Patent and Trademark Office's assessment of the specific infringement to determine which remedy or sanction is appropriate. This is decided upon request by the affected party and based on the merits of the specific case.

These administrative sanctions are independent of any monetary damages incurred by the affected party, and that could be sought through a civil action after the infringement is confirmed.

b. Standards for Infringement

In Mexico, the standards for infringement in the digital environment and the offline one are the same. The affected titleholder must prove that the infringing product includes a trademark, slogan or design that is confusingly similar to the registered right, and prove the existence of consumer confusion. The titleholder has to prove:

- the existence of a local registered right, which is entitled to protection under federal copyright law or the Mexican Industrial Property Law;
- the alleged infringer used the same or a similar trademark in commerce, covering goods in the relevant class, without consent from the titleholder; and
- the infringing trademark could create confusion in the consumer in the marketplace, which is usually inferred from the likelihood of confusion test.

Concerning criminal actions, an additional standard is publishing a notice informing consumers of the existence of the IP right, which should be done prior to the date the criminal complaint is raised, as a preliminary requisite. This publication will allow the affected party to make a damages claim later on.

c. Remedies and Penalties

As previously mentioned, the remedies that the Mexican Patent and Trademark Office may impose are monetary fines, temporary and/or final closures and administrative arrest. The decision which to impose will depend on the authority and the specific infringement.

Finally, once the decision is final, it is possible to begin an independent claim through a civil proceeding to recover damages, which may take around two or three years. The amount of the damages will be set by the Civil Court, and, in accordance with the law, its starting threshold will be not less than 40 percent of the public sale price of the infringer's products/services.

d. Obstacles to Enforcement

One of the most common obstacles in infringement actions is identifying infringers and their exact locations. Thus, it is strongly recommended that as much information as possible be gathered through investigations before taking any action, to ensure a strategic vantage in all cases.

Protection is limited to local registrations; when dealing with infringements of trademarks, designs, slogans or patents, it is necessary to have a domestic registration for there to be enforcement. In the case of copyrights, the rights holder may adduce some evidence from other countries.

4. Customs

a. Enforcement Mechanisms

Mexico has a formal trademark recordal system in place with the customs authorities. The system is independent from the Mexican Patent and Trademark Office's database, but both systems are linked. It is mandatory to have Mexican Trademark Registration before recording a trademark with customs.

With this recordation, if customs detect products entering Mexico, they inform the rights holder and provide relevant information regarding the importation, so that the rights holder will be able to determine whether the products are counterfeit or not, and provide his or her counsel with instructions to stop the merchandise at the border by initiating a criminal or an infringement action.

b. Requirements for Enforcement

Mexican customs are not empowered to proceed directly with seizures of alleged infringing products or counterfeits. It is necessary that a seizure is ordered by an administrative or judicial authority. Therefore, the rights holder must initiate criminal or administrative actions against the importation of counterfeit goods to suspend their circulation. In addition, customs authorities request that rightholders' trademark registrations be included in the database to provide them with information for taking action.

c. Considerations Relevant to the Enforcement Process

It is advisable for rights holders to have good communication with Mexican customs, in case they want to proceed with the seizure of products at the border. Attendance at the different types of training that take place during the year, at the different checkpoints around the country, is also recommended.

K. Argentina

1. Offline Infringement and Counterfeiting Trends

With respect to offline infringement and counterfeiting trends in Argentina, it is more common to find sellers on the streets commercializing counterfeit products than gray market products. Usually, these street vendors can be found in very busy areas, such as administrative places in capital cities, massive commercial neighborhoods or tourist spots. Although they may not advertize their products as original, they do use famous registered trademarks and logos to commercialize them and boost their sales.

In smaller numbers, there are shops in the aforementioned places that retail counterfeit products. However, the majority of them sell products "similar" to those that have well-known registered trademarks, but are not identified by any trademarks. It is worth mentioning that most of these products are imported from China.

Please refer to Part II (K)(2) regarding enforcement in the offline landscape in Argentina.

L. Brazil

1. Civil Action

a. Sources of Liability under Brazilian IP Laws

The Brazilian Industrial Property Law (IP Law) provides that the owner of an IPR (including trademarks, patents and industrial designs) will be entitled to request the discontinuance of the unauthorized use of such infringed rights, in addition to compensation for losses and damages.

The loss of profits corresponding to the unauthorized use of trademarks, patents or industrial designs shall be calculated by one of the following criteria, whichever is most favorable to the IPR owner: (i) the benefits that the IPR owner would have received if the infringement had not occurred; (ii) the benefits accrued by the infringer; or (iii) the remuneration that the infringer would have paid to the owner of the violated IPR for the granting of a license to allow him or her to legally exploit the registered IPR.

In the event of works protected by copyrights, the owner is entitled to request the seizure of the copies, and the infringer will indemnify the owner based on the amount of copies effectively sold (however, if it is not possible to ascertain the amount of sold copies, the infringer will pay an amount corresponding to 3,000 unauthorized copies).

Finally, apart from provisions relating to indirect infringement of patent rights (the interpretation of which is controversial), there are no specific provisions for secondary/contributory liability for violation of IPRs.

b. Standards for Infringement

The IP Law does not provide for specific criteria to determine infringement, which is decided by the courts on a case-by-case basis. Usually, establishing the infringement of IPRs depends on the concrete evidence submitted by the parties, and other aspects, such as technical evaluations (in the case of patents and industrial designs), and the degree of consumer confusion and parasitic association (for trademarks).

c. Remedies

Besides ordinary civil lawsuits, it is possible to obtain injunctions to interrupt the unauthorized use of, as well as the manufacturing, reproduction, offering for sale, sale or import of, the infringing products in the market.

In the event of reproduction or imitation of registered trademarks, the courts may order the seizure of all merchandise, products, goods, packaging, labels and other items bearing the infringed trademark.

Additionally, the courts may impose a fine for non-compliance with an order to discontinue the use of the violated IPR.

d. Obstacles to Enforcement

Besides the traditional delays associated with the civil courts, and depending on the amount of assets registered in the infringer's name, it may be difficult to effectively obtain indemnification for the unauthorized use of IPRs. However, it should be noted that a request to interrupt infringement is analyzed regardless of any assets owned by the infringer.

2. Criminal Action

a. Sources of Liability under Brazilian IP Laws

Brazilian IP law sets forth that the unauthorized use or reproduction of products/processes covered by IPRs, as well as the use of trademark and advertisement expressions to indicate a false origin of the product and mislead consumers, are defined as crimes. The penalties range from imprisonment for one month, to one year's imprisonment, plus a fine.

The infringement of copyrights and related rights is also defined as a crime, and subject to penalties of imprisonment for three months to one year, or a fine. If the individual infringed the IP owner's copyright with commercial purposes (i.e., intent of profit) the penalties are increased to two to four years, plus a fine.

Finally, unfair competition practices, such as passing off, employment of fraudulent means for the purpose of obtaining an advantage in relation to a competitor and the misleading of consumers are also deemed to be crimes, subject to penalties of imprisonment for three months to one year.

b. Standards for Infringement

The crimes set forth in the IP Law are subject to private prosecution, i.e., the initiation of criminal proceedings is subject to the filing of the criminal complaint by the offended party. The deadline for filing complaints is six months from the date on which the offended party became aware of the crime.

In cases involving patent infringement, an expert report evidencing the counterfeiting and/or infringement of patents may be required to ground the criminal complaint and start the prosecution. In these cases, search and seizure of the infringing products must be requested, to obtain samples of the products for the expert's review.

c. Remedies

The owner of the IPR subject to criminal infringement can request a preliminary search and seizure, which will be limited to a number of samples of the counterfeit product sufficient to allow technical examination. For this order to be granted, evidence of counterfeiting must be unequivocal, and the risk of financial losses and irreparable damages to the IPR owner must be accurately evidenced.

d. Obstacles to Enforcement

The short duration of the minimum imprisonment penalties for most of the crimes involving IPRs allows the public prosecutor to request the temporary suspension of prosecution for up to two to four years. After that period, if the infringer complied with certain conditions, he or she will no longer be subject to imprisonment. Imprisonment release also applies if the infringer was sentenced to imprisonment of less than four years, and the crime was not committed with violence (which is usually the case for infringement of IP). As a result, in practice, the imprisonment of an individual solely for infringement of IPRs is very rare in Brazil.

3. Administrative Action

For trademarks, patents and industrial designs, administrative remedies are available during the period of examination of applications for registration of IPRs with the Brazilian PTO, or immediately after such rights are granted.

PTO is required to analyze the registration of an IPR as being in the best interests of society. Consequently, it may reject a potentially infringing application *ex officio*. Therefore, it is essential for IPR holders to keep an attentive surveillance over their trademarks in Brazil, in order to promptly oppose conflicting applications. It is noteworthy that the analysis of such opposition usually takes more than two years to be conducted, due to the backlog PTO has been experiencing for the last decade.

4. Customs

The IP Law provides that products bearing infringed or imitated trademarks may be seized by customs officers at the time of clearance. In order to better inform the customs officers and other public agents involved in this process, the Brazilian Department of Justice and the National Council for the Combating of Counterfeit and Intellectual Property Crimes have recently created the National Directory of Trademarks for Combating Counterfeiting (the directory). The directory lists the legal representatives appointed by trademark owners to assist the public authorities in combating counterfeiting, crimes against IP and the tax evasion arising thereof, in an attempt to bring together the trademark owners and the public agents working towards their protection. The access to all directory information is managed by PTO itself, and restricted to public agents from specific entities, such as the Ministry of Justice, the Internal Revenue Service, the Brazilian Federal Police, PTO and the Federal Public Prosecutors' Office.

The contacts listed in the directory can assist public agents in obtaining samples, information, guidelines, statements and other documents regarding original products, to assist in the examination of counterfeit products seized or impounded by the public authorities and commence criminal investigations in order to prevent the commerce of counterfeit products.

Any trademark owner whose trademarks are duly registered before PTO can register with the directory by listing its trademarks, appointing legal representatives designated to oversee their enforceability, and providing information and documentation related to the protected trademarks and products, when necessary. Moreover, it is possible to have specific legal representatives responsible for different trademarks, commercial segments or government entities, as convenient for each company.

M. Colombia

1. Enforcement through Civil Infringement Actions

a. Trademarks and Industrial Designs

According to Andean Decision 486/2000, the owner of a right protected by this decision (including trademarks and industrial designs) may bring an action before the competent authority against any person infringing his or her right. In addition, it states that the owner of the infringed right may request the following measures, among others:

- cessation of all acts that constitute the infringement (this includes both online and offline landscapes);
- compensation for damages;
- withdrawal from commercial channels of all products resulting from the infringement, including packaging, wrappings, labels, printed materials or advertizing, together with the materials and implements the predominant use of which has been the commission of the infringement;
- prohibition against the importation or exportation of the products, or materials or implements referred to in the previous item;
- adjudication of the ownership of the products or materials or implements referred to above, in which case the value of such goods shall be charged to the amount of compensation due for damages; and
- adoption of the necessary measures to avoid continuation or repetition of the infringement, including destruction of the products or materials or implements referred to above, or the temporary or definitive closure of the business belonging to the defendant or the accused, or publication of the guilty verdict and notification of interested parties at the infringer's expense.

In the case of counterfeit trademark goods, the elimination or removal of that trademark shall be accompanied by actions to prevent the introduction of these products into commerce. Furthermore, such goods shall not be allowed to be re-exported in an unaltered state or to be subjected to a different customs procedure.

This measures may be requested in both the online and offline landscapes. As explained previously, enforcement of rights may be difficult in the online landscape, due to jurisdictional issues.

According to local law, the action established in Andean Decision 486/2000 is a civil action, which may be filed before the ordinary jurisdiction or before the Superintendence of Industry and Trade (which has a division that operates as the Patent and Trademark Office). It is necessary to demonstrate the existence of the right, by means of the registration certificate and the existence of the infringement. This civil action is handled through a verbal process with three main hearings. After the defendant is notified of the action, the ruling must be issued within a one-year term. Damages are available and the burden of proof is on the plaintiff. The following criteria, among others, shall be used to calculate the amount of compensation to be paid for damages:

- the consequential damage and lost profits suffered by the rights holder as a result of the infringement;
- the amount of profit obtained by the infringer as a result of the acts of infringement; or
- based on the commercial value of the infringed right and such contractual licenses as may have already been granted, the price the infringer would have paid for a contractual license.

In our experience, the superintendence has shown more efficiency and accuracy in its decisions. It is a specialized entity, with examiners who are familiar with IP matters. In addition, they comply with the legal terms to issue a final ruling on the merits of the case. The ordinary jurisdiction, on the other hand, does not have judges who specialize in IP matters, and they are not familiar with the cases. In addition, they rarely meet the legal terms.

It is important to highlight that, in addition to infringement actions, injunctive remedies are available. Any party initiating or who shall initiate an action for infringement may request the competent national authority to order immediate provisional measures for the purpose of (i) preventing an infringement from occurring; (ii) avoiding its consequences; (iii) obtaining or preserving evidence; or (iv) ensuring the effectiveness of the action or compensation for damages.

Provisional measures may be requested before starting the action, together with it, or after it has been initiated. The following provisional measures, among others, may be ordered:

- immediate cessation of all acts constituting the alleged infringement;
- withdrawal from commercial channels of all products resulting from the alleged infringement, including packaging, wrappings, labels, printed material or advertizing, or other materials, together with the materials and implements the predominant use of which has been the commission of the infringement;
- suspension of the importation or exportation of the goods or materials or implements referred to in the previous paragraph;
- establishment by the alleged infringer of an adequate guarantee; and
- temporary closure of the business belonging to the defendant or accused, if necessary, to avoid continuation or repetition of the alleged infringement.

b. Copyright

According to Andean Law 23/1982, the owner of copyrighted work may bring a civil action to the competent authority against any person infringing the right. This civil action is also a verbal proceeding, handled through hearings. Injunctive measures are also available. The claimant may request from a judge the preventive seizure of the infringing product. This measure may be requested before or together with the infringement action.

In Colombia, the competent authorities are the ordinary judges and *Dirección Nacional de Derechos de Autor* (the copyright office). As in the case of the Superintendence of Industry and Trade, the copyright office is a specialized authority, which will very likely issue a more efficient and accurate ruling on the merits of the case.

2. Enforcement through Criminal Actions

The Criminal Code establishes that any unauthorized person using patents and/or utility models, or any other right protected by law, would be subject to imprisonment of from four to eight years and fines from COP26 to COP1500 (Colombian monthly minimum wages). The use of confusingly similar patents and/or utility models, or any other right protected by law, would be punished with the same penalties.

The person who supports, provides, distributes, offers for sale, commercializes, transports or acquires with commercial purposes, products or goods in the situation described above, will be subject to the same penalties.

After the criminal action takes place and there has been a final sentence imposed, the owner of the right is entitled to request the payment of damages as a consequence of the infringement. The burden of proof of the damage is on the plaintiff. The same criteria to calculate the amount of compensation to be paid for damages in the civil action is applicable in the criminal action.

i. Specialized IP Unit

The General Attorney's Office has specialized agencies and departments dedicated exclusively to applying countermeasures against counterfeiting activities. There are units within the prosecutor's office that are exclusively dedicated to investigating and criminalizing counterfeit activities and infringements of IP rights.

ii. How to Enforce Rights

If the IP owner has knowledge of counterfeiting activities that are taking place, his or her participation in the process's initial phase is very important. The titleholder must gather the necessary information and evidence in order to convince the prosecutor to take the case, start an investigation, and take additional measures such as raids and seizures. Overall, at the initial stages, the cooperation between the titleholder and the prosecutor is essential to the criminal prosecution.

After raids and seizures take place, and/or an investigation has started, the criminal process is already underway, the prosecutor in charge.

Again, once a final sentence is imposed, the owner of the right is entitled to request the payment of damages as a consequence of the infringement.

3. Customs Recordation and Enforcement through Border Measures

In Colombia, it is possible to register trademarks with customs. This recordal helps customs to identify (i) the trademarks; and (ii) the point of contact when suspicious merchandise enters the borders. In the fashion and luxury business, this recordal is very important, as most of the counterfeit products that may be found in Colombia are imported from other countries.

In our experience, the core of successful enforcement through border measures is training. Training is essential to (i) teach and motivate customs officers; and (ii) provide customs with the tools to identify counterfeit and original goods. Custom authorities and police officers who have received training are more eager to cooperate and detain suspicious merchandise entering the borders.

i. Enforcement through Border Measures

There is a specific and advanced regulation in Colombia regarding border measures, which follows the parameters and criteria established by the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) and the Andean Community Regulation – Decision 486, formalized by Law Decree 4540 of 2006.

Apprehensions *Ex Officio* – Notifications to Registered Titleholder before Customs' Titleholder Directory

It is usual that customs authorities proceed with apprehensions *ex officio*, and notify trademark titleholders registered in their titleholder directory, in order to take action against suspicious merchandise. Apprehensions occur for different reasons listed in the Colombian Customs Statute: importing items that are not listed in the transport documentation, smuggling, lack of proper authorization in the import, or reporting different quantities of the imported merchandise, among many others.

- *Customs notice* When an apprehension takes place, customs notify trademark titleholders registered in the titleholder directory of the apprehended goods if they consider the merchandise is counterfeit. This is the main reason why training these officials is essential. The notice is usually informal, and comes with only an approximation of the quantity of the goods, and sometimes, general characteristics.
- *Preliminary verification* After receiving an initial alert from customs authorities, the official minutes on the apprehension should be obtained, to have precise information on the amounts and characteristics of the apprehended goods. This usually takes place along with a personal verification of the merchandise directly at each port, to obtain pictures of the goods, and render a preliminary expert's opinion on the authenticity of the goods on location.
- *Filing a criminal complaint before the General Attorney's Office against the importer* After confirming that the merchandise is in fact counterfeit, the trademark titleholder must file a criminal complaint against the importer of the goods. The merchandise and the case are in the control of the prosecutor's office, which will delegate to a prosecutor the obligation to obtain the destruction of the goods, and begin the investigation.
- *Meetings with the prosecutor to obtain the destruction* Once the complaint is filed, it is important to pressure the prosecutor in charge of the case to obtain the destruction of the

goods. During this process, it is also important to submit to the prosecutor identification guidelines or technical information on the products, which may help the authorities to confirm the lack of authenticity of the apprehended products, and render an official expert's opinion declaring that the items are counterfeit.
- *Destruction of the apprehended goods* Once the prosecutor in charge defines the lack of authenticity of all of the products involved in the import operation (including all trademark titleholders declared as victims in the procedure), the destruction of the goods is done directly at the port, or at closer facilities where destructions are allowed.

N. Australia

1. Civil Action

The primary sources of liability under statute and common law are as follows:
- trademark infringement: Trade Marks Act 1995 (Cth);
- copyright infringement: Copyright Act 1968 (Cth);
- design infringement: Designs Act 2000 (Cth);
- common law passing off; and
- the Australian Consumer Law (found in Schedule 2 to the Competition and Consumer Act 2010).

In various instances, secondary or contributory liability may be asserted where a party has authorized, aided, abetted or procured infringement. In these instances, liability may result from relevant statutory provisions or principles of joint tortfeasorship.

a. Standards for Infringement

Please see details on pages 45-46 for Copyrights, 52 for Industrial Designs/Designs, 55-56 for Trademarks and 61 for Patents under section "Enforcing Your IP Rights" in Chapter 1.

b. Civil Remedies

i. Trademarks

Enforcement is by civil action in the Federal Court of Australia or in the Supreme Court of a state or territory. The Federal Circuit Court is also able to hear less complex trademark matters. In practice, most proceedings are brought in the Federal Court.

Trademark owners can seek the following preliminary orders:
- an interim injunction to put a temporary stop to the allegedly infringing activities;
- a search order (also known as an Anton Piller order) for the inspection and preservation of premises, documents and articles pending trial;
- a freezing order (also known as a Mareva injunction) to stop the infringer disposing of assets or leaving the jurisdiction; and
- a Norwich Pharmacal order to find out the infringer's sources and customers.

A full range of permanent orders are also available, including injunctions to stop infringement, to hand over or destroy infringing goods, or to provide certain information, and orders for delivery up of infringing goods and the means of production. Corrective advertizing can be ordered in certain cases.

The court may order that an infringer hand over the profits it has made as a result of its infringing activities. The plaintiff must make an election between damages and this remedy. The principal disadvantage of an account of profits is the practical difficulty and cost (including expert accountants) of ascertaining the defendant's profits. However, this remedy is worthwhile if profits are likely to exceed damages. To claim damages, the plaintiff must prove the loss it has suffered as a result of the defendant's infringing acts. Damages may be available, for instance, to compensate for lost sales or damage to goodwill.

Unless notice to an infringer would be obviously detrimental, it is usual and cost-effective to attempt to enforce trademark rights by first sending a letter of demand. Costs cannot generally be demanded until after proceedings are commenced. Demand letters must be carefully framed, as there are provisions in the Trade Marks Act by which a person aggrieved by a groundless threat of legal proceedings can obtain damages.

ii. Copyright

Copyright cases in Australia are usually heard in the Federal Court and the remedies are generally similar to those available in respect of trademark infringement.

Compensatory damages for infringement are the primary remedy used. A copyright owner can claim damages for conversion in conjunction with compensatory damages for infringement. Damages are generally measured in reference to the value of the infringing copy at the date of conversion. The court has a discretion to take into account expenses incurred by the defendant and the proportion of copyright material in the infringing article. If a good comprises infringing and non-infringing material, the value of the converted good for the purpose of damages depends on whether the goods can be severed into infringing and non-infringing parts.

Where it is established that the defendant was not aware (and had no reasonable grounds for suspecting) that its actions constituted an infringement of copyright, then damages cannot be awarded, although the court can still order an account of profits. In practice, defendants rarely succeed in establishing this innocence defense.

The courts also have power to make an award of "additional damages" in circumstances of flagrant infringement.

As with trademarks, an action can be brought against someone who groundlessly threatens legal proceedings in relation to a purported copyright infringement, so care should be taken before threatening legal action.

iii. Designs

Infringement actions are brought in the Federal Court. Although the Federal Court has the powers described above in respect of trademarks, it also has the discretion to refuse to award damages or an account of profits if the defendant was not aware that the design was registered and had taken all reasonable steps to find out if it was registered.

There are no provisions under the Designs Act to award additional damages for flagrant infringement.

iv. Passing off and Australian Consumer Law

The civil remedies available in an action for passing off or breach of the Australian Consumer Law are similar to those available for trademark infringement.

c. Obstacles to Enforcement

Some of the obstacles that operate in the context of online enforcement are also applicable in an offline environment – e.g., challenges in identifying and tracing the assets of an infringer; and dealings in counterfeit or infringing goods in the context of parallel trade.

2. Criminal Action

The statutory sources of criminal liability, standards for offenses and remedies are as follows:

i. Trademarks

Under Section 146 of the Trade Marks Act, it is a criminal offense to falsely apply a registered trademark to goods or services.

A registered trademark is falsely applied if the trademark or a sign substantially identical to it is applied to goods or services without the consent of the registered owner or authorized user of the trademark.

Under section 147 of the Trade Marks Act, it is a criminal offense to make, have or dispose of a die, block, machine or instrument for the purposes of falsifying, unlawfully removing or falsely applying a registered trademark, or to draw, have or dispose of a representation, or to program a computer or other device to draw a registered trademark or a representation of a registered trademark or part of a registered trademark.

Under section 148 of the Trade Marks Act, it is a criminal offense for a person to sell or expose for sale or to possess for sale or to import into Australia, for the purpose of trade or manufacture, goods that person ought reasonably to have known had a falsified registered trademark applied or had a registered trademark unlawfully removed or falsely applied.

The maximum penalties for breaches of sections 146, 147 or 148 are fines of A$93,500 or imprisonment for five years, or both (for indictable offenses), and fines of A$10,200 or imprisonment for one year, or both (for summary offenses).

ii. Copyright

The Copyright Act provides that certain infringements of copyright in a work or other subject matter, and certain other dealings, are criminal offenses punishable by a fine, or, in some cases, by imprisonment. A person's criminal liability is a separate issue to their civil liability for the same conduct. Accordingly, a person may still be sued by the copyright owner for infringement whether or not that person is charged with a criminal offense.

Historically, prosecutions for infringements have been rare, with most copyright owners preferring to rely on their civil remedies and authorities being generally reluctant to prosecute. Australia's implementation of its obligations under the Australia–United States Free Trade Agreement (AUSFTA) and concern about the spread of online copyright infringements have, however, prompted the introduction of an enforcement regime under the Copyright Act for copyright infringement, which may increase the use of criminal sanctions. This regime includes:

- a tiered structure of indictable, summary and strict liability offenses. The tiered offenses contain similar physical elements but involve different levels of fault or intention on the part of the infringer. They provide a wide range of enforcement options for police and prosecutors, including the infringement notice regime described below;
- certain statements that a person was the owner of copyright in a work or other subject matter at a particular time contained on labels, marks, certificates or chain of ownership documents are presumed to be correct unless the contrary is established, thus assisting copyright owners to prove ownership during court proceedings, reducing litigation costs and helping facilitate prosecutions for copyright offenses;
- higher penalties for criminal offenses; and
- police powers to track and recover the proceeds of copyright crime.

Penalties imposed under the new regime aim to reflect the seriousness of the crime and the moral culpability of the offender:

Offense	***Fault Element***	***Maximum Penalty***
Summary offense	Intention (by default) and negligence	Two years’ imprisonment and/or a fine of A$13,200
Indictable offense	Intention and recklessness	Five years’ imprisonment and/or maximum fines of between A$60,500 and A$93,500 for a natural person (A corporation may be fined up to five times the amount of the maximum fine.)
Strict liability offense	No fault element required	A$6,600 (for a natural person)

Strict liability offenses are underpinned by an infringement notice scheme that allows police to issue on-the-spot fines and require the forfeiture of infringing articles. To ensure that legitimate activities of consumers and businesses are not criminalized, only select offenses have been made strict liability offenses.

Under Part V of the Copyright Act, it is a criminal offense for a person to make an infringing copy of an article with the intention of obtaining a commercial advantage or to engage in conduct that results in copyright infringements on a commercial scale. Furthermore, it is an offense for a person to sell, exhibit, expose for sale, distribute or import an infringing copy of an article, or to possess such an article with the intention of undertaking any of these activities.

Under section 132APE of the Copyright Act, it is an offense for a person to provide or offer to provide a circumvention service if the person does so with the intention of making a commercial gain. It is also an offense under section 132APD to make, distribute, offer or import a circumvention device with the intention of obtaining a financial advantage or profit.

Under subsections 132AQ of the Copyright Act, offenses are prescribed for conduct by a person in removing or altering any electronic rights management information, essentially being copyright notices, from an article in which copyright subsists.

The maximum penalties for breaches of section 132 are fines of up to A$93,500 or imprisonment for up to five years, or both. A corporation may be fined up to five times the amount of the maximum fine.

3. Administrative Action

Administrative action is not applicable to Australia.

4. Customs

i. Enforcement Mechanisms

The Australian Trade Marks Act and Copyright Act provide regimes whereby the Australian Customs Service may be empowered to seize, forfeit and destroy imported goods that infringe a registered Australian trademark or copyright.

ii. Requirements for enforcement

IP owners must lodge a notice of objection under section 132 of the Trade Marks Act and section 135 of the Copyright Act, authorizing Australian Customs to seize goods being imported that infringe their registered Australian trademarks or copyright. This authorization is provided to customs in the form of a notice of objection that includes a schedule of the IP owners' registered Australian trademarks and/or copyright works.

Once a notice of objection has been recorded, the IP owner (the objector) is notified by customs if goods infringing their trademarks or copyright are seized. Lodging a notice of objection with customs is an effective way of monitoring and preventing the importation of infringing goods.

The objector (who can also be an authorized user of the registered trademark or the licensee of the copyright) has a chance to stop counterfeit products before they enter the distribution chain. Where such a notice has been given, customs is obliged to seize such goods unless it is satisfied that there are no reasonable grounds for believing that the importation of the goods constitutes an infringement of the relevant trademark or copyright. This has several advantages:

- the importer loses its entire investment at once;
- it can be achieved with little outlay; and
- if it becomes known among importers that the owner of the trademark or copyright has a notice in place, there will be a tendency to avoid imports of counterfeits infringing upon those rights.

The following are the key steps involved in the Australian Customs seizure process:

- Once goods are seized, the objector will be informed and permitted to inspect or remove multiple samples of the seized goods, in return for the objector providing customs with an undertaking to return or replace the goods if they are found to be genuine. This is to enable the objector to make a more informed determination as to whether the consignment contains infringing goods.

- Customs will be required to give an objector any relevant information that would assist him or her in identifying the person or entity (whether within or outside Australia) that made arrangements, on behalf of the designated owner of the goods, for the goods to be brought to Australia.
- Once a notice of seizure is received, if the designated owner wants to claim the goods, the designated owner will have 10 working days (the claim period) to file a claim for return with customs. If a claim for return is not filed, the seized goods will be deemed forfeited and subsequently destroyed.
- If a claim for return is filed, the objector will need to seek an injunction from the court within 10 business days (the action period) to prevent the goods from being released to the designated owner.
- If seized goods are forfeited, they will be destroyed after 90 days.
- Customs may allow the designated owner to make a late claim for the release of seized goods after the end of the claim period, in limited circumstances.
- Customs notices last four years and can be renewed for as long as the relevant right remains in force.
- Objectors are required to pay no upfront bond in relation to a customs notice. However, they are required to provide a written undertaking that they will reimburse all expenses incurred by customs as a result of a seizure. In practice, these costs are generally minimal.

O. China

In the offline world, brand owners have a number of enforcement options to protect trademark rights: civil actions, criminal actions, administrative actions and customs enforcement.

1. Civil Action

Trademark infringements litigation is primarily handled pursuant to the PRC Trademark Law and the Interpretation of the Supreme People's Court on Several Issues Concerning the Application of the Law to the Trial of Civil Dispute Cases Involving Trademarks, which provide that the following acts constitute an infringement of the exclusive right to use a registered trademark:

- use, without the permission of the trademark registrant, of a trademark that is identical to a registered trademark on identical goods;
- use, without the permission of the trademark registrant, of a trademark that is similar to its registered trademark on identical goods, or use of a trademark that is identical or similar to its registered trademark on similar goods, where it is likely to cause consumer confusion;
- use of a registered trademark, without the permission of the trademark registrant, within a trade name used "prominently" on goods that are similar or identical to those for which the mark is registered;

- use of a registered trademark that is a reproduction, imitation or translation of a well-known mark for goods that are dissimilar to those for which the well-known mark is registered;
- sale of goods that infringe the exclusive right to use a registered trademark (unless the goods were obtained lawfully from an identified supplier);
- forgery or unauthorized manufacture of representations of another's registered trademark, or the sale of representations of a registered trademark that were forged or manufactured without authorization;
- substituting the trademark of a trademark registrant without its consent and putting the goods bearing such substituted trademark back onto the market;
- deliberate facilitation of infringement or assistance to an infringer of another's exclusive right to use a registered trademark;
- registration of a domain name that is similar to a registered trademark and use of such domain name in relation to goods that are similar to those for which the mark is registered; and
- causing other harm to another's exclusive right to use a registered trademark.

Civil damages in trademark infringement cases are generally determined by actual losses suffered by the brand owner as a result of the infringement. Where actual losses are difficult to determine, civil damages are determined by the benefits gained by the infringer. If both the actual losses and benefits gained are difficult to determine, civil damages can be assessed based on a reasonable multiple of the royalties for the registered trademark. Where the plaintiff's losses, the defendant's benefits, and trademark royalties cannot be easily proved, the revised Trademark Law allows the People's Courts to award statutory damages of up to RMB3,000,000 (approximately US$493,000). The exact amount of the statutory damages award is based on factors such as:

- the nature, period and consequences of the infringement;
- the reputation of the trademark;
- the amount of trademark licensing royalties normally paid on sales of the genuine item;
- the types, periods and scopes of trademark licenses for the mark; and
- the reasonable expenses incurred in stopping the infringement.

Further, the People's Courts can compensate trademark owners for enforcement-related expenses, including legal and investigation costs (although such awards are normally modest). Punitive damages may be awarded in cases involving bad faith infringements of a registered trademark, and where the circumstances of the infringement are serious, the damages as determined by the previous methods can be multiplied up to three times.

The PRC Trademark Law also allows trademark registrants or interested parties to apply to the People's Courts for (i) pre-trial injunctions against actual or threatened acts of infringement; (ii) preservation orders to protect property; and (iii) preservation of evidence orders. To obtain a pre-trial injunction or a preservation order to protect property, the applicant must provide evidence that shows:

- an ongoing or imminent act of infringement by another; and
- failure to halt the act immediately would damage the lawful rights and interests of the trademark registrant or an interested party and such damage would be difficult to remedy.

To apply for a preservation of evidence order, the trademark registrant or materially interested parties must show that evidence might be destroyed, lost or difficult to obtain later. The People's Court is required to decide on the application within 48 hours and may order the applicant to provide security when granting the order.

Previously, trademark litigants could expect civil actions to proceed slowly from the start of legal proceedings until the final result or award. Now, however, most civil actions are decided within nine to 18 months. Delays of up to three years are still possible but usually only occur in cases with politically sensitive subject matter or complicated legal issues.

2. Criminal Action

Criminal enforcement of the infringement of trademark rights is governed by the PRC Criminal Law, under which the following acts of trademark counterfeiting may constitute a crime if the circumstances qualify as "serious":

- use of a trademark identical to a registered trademark on the same type of goods without the permission of the owner of the registered trademark;
- sale of goods with the knowledge that they bear a counterfeit registered trademark; and
- forgery or manufacture of representations of another person's registered trademark without authorization, or sale of representations of a registered trademark forged or manufactured without authorization.

If the circumstances are "serious", the defendant can be sentenced to up to three years' imprisonment and/or be required to pay a fine. If the circumstances are "exceptionally serious", the defendant can be sentenced to a minimum of three years' and a maximum of seven years' imprisonment and be fined. The People's Court usually determines whether a particular case qualifies as "serious" or "exceptionally serious", based on the value of the infringing goods involved.

3. Administrative Action

A trademark registrant or an interested party may file a complaint seeking administrative remedies for trademark infringement with AIC or the Technical Supervision Bureau (TSB).

For general trademark infringement, AIC is empowered to investigate premises and seize property without the need for search warrants or other lengthy procedural requirements. Where infringement has occurred, AIC can impose fines, seize infringing goods and tools of infringement, destroy representations of trademarks, issue injunctive orders to prohibit further acts of infringement, etc. AIC may also mediate compensation negotiations if both parties consent, even though AIC lacks the power to order compensation in trademark infringement cases.

For counterfeit or "fake and inferior' products, TSB may intervene in much the same way as AIC. Like AIC, TSB can investigate premises and seize property without the need for search warrants or other lengthy procedural requirements. TSB can also order the confiscation of products and impose fines. However, TSB can only punish and penalize infringers under the Product Quality Law, which means that it cannot order the broader range of remedies and penalties that are available under the Trademark Law.

4. Customs Enforcement

Under the current PRC Customs Regulations, holders of trademarks registered in China may apply for protection of trademark rights via customs recordal. Recordals last for 10 years, provided the underlying right remains valid throughout the period.

If customs detects goods that it suspects of infringing a trademark and an appropriate customs recordal is in place, customs will detain the goods and ask the brand owner for a quick confirmation of whether the goods are infringing and whether formal enforcement measures will be requested. If the brand owner wishes to request enforcement measures, it must post a seizure bond (a customs recordal substantially reduces the amount required for the seizure bond) and submit an application with supporting documents. Customs will then seize the goods while it investigates and make an infringement determination within 30 working days after the seizure.

If customs determines that the goods are infringing, PRC customs rules require the confiscation and disposal of the goods. If customs cannot determine whether the goods are infringing, the brand owner must obtain a preliminary injunction or other notice of assistance from a civil court within 50 working days after the seizure, in order to continue to challenge the importation of the goods. If customs determines the goods are non-infringing, customs may return the goods to the exporter. The brand owner may bring an administrative action to challenge customs' decision, but the effectiveness of this challenge may be limited if the goods have already been released.

If a customs recordal is not in place, the process is similar, except that the brand owner will normally have to post a significantly higher seizure bond and must obtain a preliminary injunction or other notice of assistance from a civil court within 20 working days from the date of the seizure.

A brand owner must update his or her customs recordal with any changes in his or her IP. Customs has the power to cancel recordals, either unprompted or upon application by an interested party if the failure to update has seriously affected the legitimate import or export operations of others or the discharge of customs' duties in supervising and managing import and export activities. Customs encourages brand owners to provide it with updated lists of authorized factories and exporters.

5. Secondary Liability

Market operators (e.g., a mall operator) and e-commerce platform operators are responsible for taking reasonable steps to deter acts of trademark infringement according to the Opinions on Further Cracking Down on the Infringements of Intellectual Property Rights and the Production and Sales of Counterfeit 2011.

In July 2011, the Beijing Higher People's Court issued a series of decisions (e.g., in the *Silk Street* case) that clarified the duty of care for landlords in preventing acts of trademark infringement by tenants. For example, landlords have a duty to supervise the authenticity and quality of the goods sold on their premises and must take reasonable measures to immediately stop the sale of infringing goods upon notification by the brand owners. Failure to exercise this duty of care properly may result in joint liability with the infringer.

Third parties may also be criminally liable if knowingly providing infringers with production or operating facilities, transportation, storage, import–export agency services, or other assistance, and shall be punished as an accomplice under article 16 of the Interpretation of the Supreme People's Court and the Supreme People's Procuratorate Concerning Some Issues on the Specific Application of Law for Handling Criminal Cases of Infringement upon Intellectual Property Rights 2004.

The PRC Trademark Law also imposes secondary liability on any third party who deliberately facilitates the infringement of another's exclusive right to use a registered trademark or assists another in infringing the exclusive right to use a registered trademark.

P. Hong Kong

Over the years, Hong Kong has developed a comprehensive legal framework to deal with offline infringements by offering protection for copyright, trademarks and registered designs. A wide variety of measures are available to assist rights holders to enforce their rights, such as civil actions, criminal sanctions and customs enforcement actions.

1. Civil Actions

The majority of infringement cases in Hong Kong can be addressed and resolved through the issuance of a C&D letter to the infringers, coupled with the threat of legal action. In the event that civil actions are indeed required, a wide range of interlocutory actions and remedies are also accessible to rights holders in Hong Kong.

Rights holders may elect to bring civil actions in the Small Claims Tribunal, the District Court or the High Court, depending on the type of remedies and the amount of damages sought. Remedies such as injunctions, delivery up of infringing goods, award of costs and damages, and account of profits are generally available to rights holders. A number of interlocutory actions are also available and can be obtained relatively quickly against an infringer. These include:

- an interim injunction to prevent the infringer from continuing his or her infringing activities before trial;
- an Anton Piller order that requires the infringer to permit representatives of the rights holder to enter his or her premises to search and collect relevant evidence;
- a Mareva injunction to preserve the infringer's assets; and
- a prohibition order to prevent the infringer from leaving Hong Kong.

Damages will usually be awarded according to the losses the rights holder has incurred (or notionally have incurred) as a result of the infringer's activities. This could be the value of lost sales or the royalties that the rights holder would have obtained, had the rights holder given the infringer a license to use the IP rights. Damages are intended to be compensatory in nature.

It is also common for the infringer to be asked to hand over all remaining inventory of the infringing goods and related material, e.g., advertizing brochures. The rights holder can choose to have the goods delivered up, destroyed or otherwise disposed of as the court directs.

Following a successful trial, the rights holder can expect to recover some but not all of the legal costs (typically between 60 and 75 percent), which is done by way of taxation.

2. Criminal Enforcement

It is a criminal offense under the Trade Descriptions Ordinance to apply a false trade description, to forge a trademark to goods, or to sell any goods bearing a false description or forged trademark, namely counterfeit products.

Hong Kong Customs, which is responsible for the enforcement of the Trade Descriptions Ordinance, has powers under the ordinance and can raid any premises suspected of storing infringing goods and related documentation. It also has the power to arrest suspects who are involved in the infringing activities.

In order to secure assistance from Hong Kong Customs, rights holders are required to record their rights with Hong Kong Customs by providing evidence of their IP rights and the infringer's activities. In practice, Hong Kong Customs will only take action when there is clear infringement and the rights holder has a representative in Hong Kong who has the expertise to examine the seized goods and to confirm that they are counterfeits in nature. That person is often required to make a statement regarding his or her examination and may also be required to testify during the criminal trial of the infringer. Customs would ordinarily ask to meet and interview the representative, to ensure he or she is sufficiently knowledgeable before accepting them to be an authorized expert examiner.

Criminal cases about these offenses are usually heard in the Magistrates' Courts. However, more serious offenses can be heard in the District Court or the High Court, depending on the penalties and fines that may be imposed on the infringers.

The maximum penalty for a conviction on an indictment for applying a false trade description or using a forged trademark on goods without the consent of the trademark owner is a fine of HK$500,000 and a sentence of five years' imprisonment.

However, a criminal conviction is not always a good deterrent to the offense because penalties imposed by the courts (e.g., the Magistrates' Courts) on conviction can be relatively light, although repeat offenders may face custodial sentences. On the other hand, once the infringer has been raided and criminally convicted, the criminal conviction may be used to establish liability in a follow-up civil action.

3. Customs Enforcement

Hong Kong Customs is also responsible for monitoring the imports and exports of goods in Hong Kong. Accordingly, they have the power to seize counterfeit goods. They are capable of conducting random checks on goods entering and leaving Hong Kong. If an officer locates suspected infringing goods, Hong Kong Customs will detain the goods and contact the rights holders for verification. If the detained products are verified to be counterfeit, Hong Kong Customs can seize the goods and prosecute the importer/exporter.

Rights holders can also apply for a civil detention order from the Court of First Instance of the High Court if he or she has reasonable grounds for suspecting that infringing goods will be imported into Hong Kong. This is the case even if the infringing goods have not been actually taken off the vessel and unloaded in Hong Kong. Once the order is made by a court, Hong Kong Customs will conduct the necessary search and seizure operations.

Q. Japan

1. Civil Action

Sources of Liability under Statute and Common law

Producers and importers of counterfeit goods will be liable under the Trademark Act and the UCPA. Indirect infringement established under Japanese case law may make liable parties who are not necessarily involved in the production of counterfeit products themselves, but provide essential assistance for infringing activities. Online shopping mall operators, as discussed in the *Chupa Chups* case, are one such example. There is not authoritative jurisprudence in Japan where landlords have been found liable for IP infringement by tenants.

a. Standards for Infringement

Standards for regular infringement and online infringement are the same, and the courts will apply the same tests (see section 2(c) above).

b. Civil Remedies and Criminal Penalties

Available remedies are injunctions (both permanent and preliminary injunctions), restraining orders, and damages. Injunctions under the Trademark Act are statutory remedies and are not subject to the discretion of the courts. The courts must grant injunctive relief if the plaintiff proves infringement or likelihood of infringement. Similarly, injunctions under the UCPA are granted as long as a plaintiff establishes the statutory requirements; however, the requirements under the UCPA include “for the purpose of gaining unjust benefit”, which can sometimes be difficult for the plaintiff to prove. For preliminary injunctions, bonds are required.

Because disputes over compensation tend to be expensive and time-consuming, often brand owners will only seek cease and desist of infringing activities and not monetary compensations.

Criminal penalties are also prescribed in the Trademark Act and the UCPA. Trademark infringement can be punished by imprisonment not exceeding 10 years and/or a fine of not more than JPY10,000,000. If a representative, agent, or employee commits trademark infringement in connection with his or her job, the company can be punished by a fine of not more than JPY300,000,000.

c. Obstacles to enforcement

While there are many counterfeits sold throughout Japan, generally the amount of counterfeits sold by each seller is not great. Therefore, the amount of damage to be compensated by each seller can be small. As most manufacturers are based overseas, typically in China, enforcement of IP rights against manufacturers is often not feasible. Therefore, it is essential for brand holders to take legal action against infringers (e.g., sellers and importers of infringing products) in Japan and to file petitions with the customs office requesting seizure of counterfeits, as we discuss further below.

2. Criminal Action

Both the Trademark Act and the UCPA criminalize violations of the act. The number of cases where there has been criminal law enforcement, such as investigations and/or filing a criminal lawsuit, has continuously been high. The number of counterfeits of luxury brand products seized by the police department in 2012 was approximately 117,000. The key to having law enforcement take these actions is to file with the police department a criminal accusation explaining the details of the infringement. This should include the damage caused by the infringement and sound evidence of infringement, including the subjective elements (e.g., intention and/or purpose) of the crime. Customs offices sometimes file criminal accusations with the police in cases where large numbers of infringing products are being imported.

3. Customs

a. Enforcement Mechanisms

Pursuant to the Customs Act, when the customs office detects suspicious goods in cargos during its inspection, it keeps the goods within its control and conducts further inspections. Such inspections often include communication with the owner of the IP rights that are potentially infringed by the importation to analyze whether the detected products are genuine or counterfeits. Once the goods are found to be infringing products, they are seized permanently by customs.

b. Requirements for Enforcement

The Japanese Customs Act provides a recordal system with respect to customs seizure. Those who wish customs to seize counterfeits at the border may file a petition to record their trademarks and examples of counterfeit products. Based on this recordal, the customs office seizes the goods that constitute the infringement, as described in the petition.

In theory, the Customs Office has discretionary power to seize infringing products without any petition by IP rights holders. However, in practice, the Customs Office tends to enforce its power more frequently for companies who file petitions.

c. Considerations Relevant to the Enforcement Process

When the Customs Office enforces its discretionary power to seize infringing products that are not recorded, it contacts the brand holder or his or her legal agent and requests the brand holder to confirm if the detected goods are counterfeit. On the other hand, when the Customs Office seizes infringing products that are recorded with customs, it completes the seizure process without making such inquiry to the IP rights holder. As such, updating the petition to record new infringing products results in more prompt seizure of infringing goods.

R. Singapore

1. Civil Action

a. Sources of Liability under Statute and Common Law

Depending on whether the counterfeit goods have infringed the brand owner's registered trademark, copyrighted literary or artistic work, registered designs, or used a get-up that is confusingly similar to that of the brand, rights owners may potentially rely on actions in trademark infringement, copyright infringement and passing off to bring an enforcement action.

i. Trade Marks Act

The Trade Marks Act of Singapore provides proprietors of registered trademarks with certain exclusive rights in the trademarks. It is an infringement of a registered trademark for a person to use, in the course of trade a sign:

- that is identical to the registered trademark in relation to identical goods or services for which the trademark is registered;
- that is identical to the registered trademark in relation to similar goods or services, if there exists a likelihood of confusion on the part of the public; or
- that is similar to the registered trademark in relation to identical or similar goods or services, if there exists a likelihood of confusion on the part of the public.

In respect of well-known trademarks that are also registered trademarks under the Trade Marks Act, infringement proceedings may be commenced against the use of an identical or similar mark, even for dissimilar goods or services, if such use is likely to indicate a connection between those goods and services and the proprietor of the well-known mark, there exists a likelihood of confusion on the part of the public because of such use, and the interests of the proprietor are likely to be damaged by such use.

However, a trademark will not be infringed if a person uses his or her own name or the name of his or her place of business, or a sign to indicate some characteristic of his or her goods or services, or the time of production of goods or the rendering of services, or their intended purposes, provided that such use is in accordance with honest practices in industrial or commercial matters.

The definitions of how the court determines what constitutes infringing or counterfeit goods, articles or materials and what constitutes a counterfeit trademark are set out below.

Infringing Goods

Goods are "infringing goods" if they or their packaging bears a sign identical with or similar to that of a registered trademark and:

- the application of the sign to the goods or their packaging is an infringement of the registered trademark;
- the goods are proposed to be imported into Singapore and the application of the sign in Singapore to the goods or their packaging would be an infringement of the registered trademark; or

- the sign has otherwise been used in relation to the goods in such a way as to infringe the registered trademark.

ii. Copyright Act

There is no need for copyright owners to register their works in Singapore.

The copyright owner of an artistic work has the exclusive right to reproduce the work in material form, whether two-dimensionally or three-dimensionally, to publish the work in Singapore or any country in relation to which the Copyright Act applies, and to communicate the work to the public.

Copyright gives the owner of literary, dramatic and musical works the exclusive right to reproduce the work in material form, publish the work (if the work is unpublished), perform the work in public, communicate the work to the public and make an adaptation of the work. All of the above also apply to works that are an adaptation of the original work. In addition to these rights, the owner of the copyright in a computer program (which is protected as a literary work) also enjoys the right to enter into commercial rental arrangements in respect of the program.

Infringement of copyright is a civil wrong as well as a criminal offense. Infringement may be primary, i.e., the doing (or authorizing of the doing) of acts conferred exclusively on the owner of copyright, by a person other than the owner and without the owner's consent, or secondary, i.e., unauthorized commercial dealing in infringing copies of copyright-protected works.

Following the promulgation of the 2005 amendments, the traditional remedies that may be obtained in a civil action for infringement have been supplemented by the additional remedy of statutory damages. To seek statutory damages, the copyright owner does not have to prove his or her losses or the infringer's profits. Instead, there is a list of factors for the court to consider when awarding statutory damages of up to S$10,000 for each infringing work, subject to an aggregate of S$200,000.

iii. Common Law Tort of Passing Off

In enforcement actions, the common law tort of passing off may be relied upon to protect trade names, unregistered trademarks, or other trade dress or get-up used by the rights owners, from unauthorized use by counterfeit goods.

To succeed in an action for passing off, the plaintiff must establish that:

- the goods or services he or she supplies have acquired a certain goodwill and reputation in Singapore;
- the actions of the defendant have caused, or in all probability will cause, ordinary purchasers or customers of the plaintiff's goods or business to believe that the goods or business of the defendant are/is that of the plaintiff; and
- in consequence, the plaintiff has suffered or is likely to suffer damage to his or her trade or business.

The fact that a trademark is registered does not prevent a complainant from commencing a passing off action, provided the requirements of the tort can be satisfied.

iv. Secondary/Contributory Liability

While Singapore Law recognizes secondary/contributory liability, the test of such liability tends to be fairly strict and there is little judicial precedent on successful secondary liability actions against intermediaries.

Although there is no express legislation and/or regulation that renders an intermediary jointly and/or vicariously liable for infringing activities conducted on his or her premises, it may be possible to establish liability on the part of an intermediary under the common law by proving that the landlord was a joint tortfeasor with regard to the relevant tortious acts of IP infringement committed by his or her tenants.

An intermediary may be deemed to be a joint tortfeasor if it can be proven that:

- the intermediary had conspired with the infringer or had induced the infringer to commit the relevant acts of IP infringement. This is a high threshold to cross, as it would be necessary to establish an actual inducement of the infringement or to obtain evidence of an agreement or understanding to carry out acts of infringement.; or
- that the intermediary and the infringer had joined in a common design pursuant to which the IP infringement was committed. It should be noted that for parties to operate in furtherance of a common design, it is not necessary for them to have mapped out a plan. Tacit agreement will also suffice.

In addition, NSPs and e-commerce platform providers are generally in a position to rely on certain safe harbor protections by having a robust take-down regime in place.

b. Standards for Infringement

The standard of proof in civil actions for trademark infringement, copyright infringement or passing off is based on a balance of probabilities. The standard of proof for criminal offenses under the Trade Marks Act or the Copyright Act is that of beyond reasonable doubt.

c. Remedies and Penalties

i. Civil Remedies

General

The owner whose IPRs have been infringed may bring a civil action against the infringer to seek, where appropriate, an injunction, an order for delivery up and/or destruction of infringing goods, an account of profits or damages, and costs. Civil proceedings are usually commenced by the issuance and service of a writ of summons, with the infringer named as the defendant. Particulars supporting the cause of action against the defendant will have to be provided. Depending on the complexities and other unique features of the case, the time between the commencement of a civil action and when it is finally tried and decided by the court of first instance ranges from nine months to two years. In clear-cut cases where there are no factual disputes involved, and where the legal rights of the plaintiff are clearly beyond doubt, summary judgment may be available against the defendant without the need to proceed to a full trial. Civil appeals to a higher court generally take about six months to a year to be heard.

Interim Measures of Protection

Since it may take some time before a civil action is determined by the court at trial, courts in Singapore may grant the following types of interim relief to prevent injustice to litigants:

Interlocutory Injunction

This remedy is to prevent the defendant from continuing his or her alleged infringing activities until trial of the action. Such a remedy may be sought at the time legal action is commenced, or at any time thereafter. An application for an interlocutory injunction may be made on an *ex parte* basis (i.e., without serving the application for the injunction on the defendant or his or her solicitors). Practice directions issued by the courts require that notice of the *ex parte* application be given to the respondent unless the giving of such notice would defeat the purpose of the *ex parte* application. Where an *ex parte* application is made, the plaintiff has a duty to make in his or her application full and frank disclosure of all material facts. Such facts would include those that are known to the plaintiff, as well as those that the plaintiff would have known if he or she made proper enquiries.

Alternatively, the application may be made on an *inter partes* basis (i.e., with the defendant or his or her solicitors served with the application for the injunction).

The grant of an interlocutory injunction is subject to the court's discretion, and will usually require the following to be satisfied:

- there has been no undue delay in making the application;
- there is a serious question to be tried as between the parties;
- if the injunction were not granted, and the plaintiff were to succeed at trial, damages would not be an adequate compensation for his or her loss;
- if the injunction were to be granted, and the defendant were to succeed at trial, he or she would be adequately compensated under the undertaking as to damages that the plaintiff is usually required to give as a condition for the grant of the injunction; and
- the balance of convenience lies in favour of the plaintiff.

In exercising its discretion, the court often considers the broad question of whether the interests of justice would be better served by granting or refusing the interlocutory injunction order.

Although an interlocutory injunction is only meant to last until trial, cases are frequently settled out of court after an interlocutory injunction order is granted, to restrain the defendant from continuing his or her infringing activities.

Search Order

A search order (previously known as an Anton Piller order) is, in essence, a civil search and seizure warrant, which may comprise different orders. The search order is aimed at preventing the destruction or concealment of evidence of wrongdoing.

In general, the principal order is to allow the plaintiff applicant to enter the defendant's premises to inspect and seize infringing articles and/or documents required as evidence, for the safekeeping of an independent supervising solicitor or the court. An order ancillary to the principal order is that for discovery, where the defendant is required to supply information and to disclose and produce documents to the plaintiff, unless there is a real risk that such disclosure will be self-incriminating.

An application for a search order is invariably made on an *ex parte* basis. As a consequence of the potentially draconian effects of a search order, the grant of a search order is made only after four essential preconditions have been fulfilled by the plaintiff:

- There must be an extremely strong *prima facie* case against the defendant.
- The damage (potential or actual) to the plaintiff must be very great if the order were not granted.
- There must be clear evidence that the defendant has incriminating evidence in his or her possession.
- There must be an imminent risk that the defendant may destroy such incriminating evidence before any *inter partes* application can be heard. The presence of such a risk can generally be assumed in counterfeiting cases.

In an application for a search order, both the plaintiff and the plaintiff's solicitors will be required to provide undertakings to the court. Further, the plaintiff has a duty to disclose to the court all matters that are within his or her knowledge and that are material to the proceedings. A non-disclosure of relevant facts may lead to a discharge of the search order at the *inter partes* stage. To ensure propriety during the execution of the search order, it is also necessary to engage the services of an independent solicitor to supervise and prepare a written report on the execution of the order.

A search order has to include a notice to the defendant informing him or her of his or her obligations and rights upon the execution of the order. For example, the defendant may exclude the presence of anybody who may gain commercially from anything he or she might read or see on the defendant's premises during the execution. The defendant may also refuse to permit entry into his or her premises before 9:00 a.m. or after 5:00 p.m. on weekdays or at all on Saturdays, Sundays and public holidays.

Before the court grants a search order, the court will balance the plaintiff's right to preserve important evidence against the violation of the privacy of a defendant who has had no opportunity to put forward his or her case at the stage of application of the search order.

Mareva Injunction

This form of interlocutory injunction (which is named after the case in which such an injunction was first granted) prevents a defendant from negating the effect of a judgment by dealing with or disposing of his or her assets before execution of the judgment may be levied.

As in the case of a search order, an application for a Mareva injunction is invariably made on an *ex parte* basis. To obtain a Mareva injunction, the following has to be established to the satisfaction of the court:

- the plaintiff has a good arguable case;
- there are grounds for believing that the defendant has assets within the jurisdiction of Singapore; and
- there is a real danger that these assets will be removed from, or dissipated within, the jurisdiction before any judgment or award against the defendant is satisfied.

As in the case of all *ex parte* interlocutory injunctions, the plaintiff is required to give in his or her application full and frank disclosure of all material facts. In addition, the plaintiff is required to undertake to abide by any order the court may make as regards damages that may be suffered by the defendant or any innocent third party by reason of the grant of the Mareva injunction. A typical Mareva injunction order will specify the maximum monetary amount that will be affected by the order and provide that the defendant and/or third party affected by the order may apply to set it aside or vary it upon giving notice to the plaintiff.

In appropriate cases, other orders ancillary to the Mareva injunction may be granted by the court in order to enable the Mareva injunction to be truly effective. These ancillary orders may include an order for the defendant to disclose on oath all his or her assets wherever situated, an order for the defendant to deliver up specific assets (such as chattels) and an order to restrain the defendant from leaving the country. Ancillary orders may also be made against a plaintiff, such as requiring him or her to fortify his or her undertaking as to damages by providing an insurance bond or bank guarantee, and in the case of a foreign plaintiff, for provision of security for the costs of the action.

Final Orders

Should the case proceed to trial and the plaintiff succeeds in establishing his or her claim against the defendant, the following orders may be made against the defendant:

<u>*Final Injunction*</u>

A perpetual injunction order may be made against the defendant to restrain him or her from engaging in any further infringing activities.

<u>*Damages*</u>

The general rule is that the quantum of damages awarded should be, as far as possible, the sum of money that would put the IPRs owner in the same position he or she would be in had his or her IPRs not been infringed by the defendant.

Such damages would usually be measured by the amount of profits lost by the plaintiff by reason of the defendant's infringing activities, or the amount of reasonable royalty that would otherwise have to be paid to the plaintiff by the defendant. In relation to copyright infringement, the Copyright Act expressly provides that the copyright owner may also be awarded "additional damages" over and above the normal quantum of damages in appropriate circumstances. Factors the court will take into account in deciding whether or not to award additional damages include the flagrancy of the infringement and any benefit shown to have accrued to the defendant by reason of the infringement.

Alternatively, the plaintiff may elect to receive an account of profits the infringer made from his or her infringing activities. An account of profits would be preferred in a case where the defendant's profits are far in excess of any profits the plaintiff would have made or where the plaintiff has difficulty quantifying the loss he or she had suffered.

In addition, a trademark and/or copyright owner may elect for statutory damages. The election for statutory damages is useful in situations where it is difficult for the trademark and copyright owner to prove the quantum of actual losses. It also serves as an additional deterrent against infringers.

Under the Trade Marks Act, the maximum limits for statutory damages are S$100,000 (for each type of counterfeit goods or services), and up to S$1,000,000 in aggregate. An exception arises where the trademark owner is able to prove that actual loss resulting from the infringement exceeds S$1,000,000. In awarding statutory damages, the court is to have regard to the following:

- the flagrancy of the infringement of the registered trademark;
- any loss that the IPRs owner has suffered or is likely to suffer by reason of the infringement;
- any benefit shown to have accrued to the infringer by reason of the infringement;
- the need to deter other similar instances of infringement; and
- all other relevant matters.

Under the Copyright Act, the maximum limits for statutory damages are S$10,000 (for each infringing work or subject matter), and up to S$200,000 in aggregate. An exception arises where the copyright owner is able to prove that his or her actual loss exceeds S$200,000. In awarding statutory damages, the court is to have regard to the following:

- the nature and purpose of the infringing act, including whether the infringing act was of a commercial nature or otherwise;
- the flagrancy of the infringement;
- whether the infringer acted in bad faith;
- any loss that the IPRs owner has suffered or is likely to suffer by reason of the infringement;
- any benefit shown to have accrued to the infringer by reason of the infringement;
- the conduct of the parties before and during the proceedings;
- the need to deter other similar instances of infringement; and
- all other relevant matters.

Delivery Up for Destruction

The defendant may, in addition, be required to deliver up to the plaintiff all remaining stocks of infringing goods and/or associated materials, such as packaging, labels and promotional literature, for destruction by the plaintiff.

Costs

Costs on a standard basis (i.e., "party and party" costs) are usually awarded to a successful litigant. However, such costs are generally insufficient to cover the fees that that successful litigant would have to pay his or her solicitors (i.e., "solicitor and client" costs). Unsuccessful litigants will have to bear not only their own solicitors' costs, but also the party and party costs of the successful litigant.

Contempt of Court

Disobeying a court order, especially an injunction or a search order, is a very serious matter and amounts to contempt of court. The usual forms of punishment for a party in contempt of court include a warning, a fine or an order for committal to prison. Costs may also be awarded against the party in contempt. A breach of an undertaking given to the court also amounts to contempt of court.

d. Obstacles to Enforcement

One of the obstacles in enforcement actions is the issue of dealing with intermediaries. Often, these intermediaries are involved in arranging for transhipment of the counterfeit goods through Singapore to a neighboring country. On one hand, the intermediaries may claim that they are not the importers of the counterfeit goods and that they are not using the rights owners' signs. On the other hand, locating the persons who have requested the transportation of these counterfeit goods in the neighboring country can be challenging, as it requires a lot of investigation.

2. Criminal Action

Please see the information on civil action above.

a. Criminal Prosecution

Offenses under the Copyright Act and the Trade Marks Act may be dealt with by way of private prosecution by IPRs owners whose rights have been infringed, acting upon the authorization of the Attorney-General's Chambers (AGC).

Prior to such prosecution, IPRs owners will usually file complaints with the courts for criminal search and seizure warrants. Such warrants allow for the entry into and search of any premises which are believed to contain infringing articles, and for the seizure of such articles. The Intellectual Property Rights Branch of the Singapore Police Force (IPRB) administers the execution of the warrants. The scope of the warrants extends to infringing articles as well as documents evidencing the commission of an offense.

The seized articles are then used as evidence of infringement at the criminal trial. Under the Copyright Act and the Trade Marks Act, criminal proceedings must be instituted within six months of seizure, failing which the goods and/or documents seized shall be returned.

Recent successful prosecutions of infringers have resulted in prison terms and hefty fines being imposed by the courts. For example, on the software piracy front, although worldwide software piracy is reported to have risen from 38 percent in 2007 to 42 percent in 2013, Singapore is reported to have reduced the percentage of counterfeit personal computer software in the local market from 37 percent in 2007 to 33 percent in 2013. This has been largely due to relentless enforcement initiatives carried out by the Singapore authorities.

i. Offenses under the Trade Marks Act

Under the Trade Marks Act, any person who imports, sells or exposes for sale, or has in his or her possession for the purpose of trade or manufacture, any goods to which a registered trademark is falsely applied shall be guilty of an offense unless he or she proves that having taken all reasonable precautions against committing the offense, he or she had no reason to suspect the genuineness of the mark, and had on demand made by or on behalf of the prosecution, given all information in his or her power relating to his or her source, or that he or she had acted innocently. The offense carries a fine of up to S$10,000 for each infringing item (subject to a maximum aggregate fine of S$100,000) and/or a prison term of up to five years.

Likewise, a person who makes a sign identical to or so nearly resembling a registered trademark as to be calculated to deceive, or who falsifies a genuine registered trademark by alteration, addition, effacement, partial removal or otherwise, without the consent of the owner of the registered trademark shall be guilty of an offense and liable on conviction to a fine of up to S$100,000 and/or a prison term of up to five years.

In addition, the Trade Marks Act expressly provides that proceedings for offenses may be brought directly against a director, manager or other similar officers of a body corporate, if such offenses are proved to have been committed with their consent or connivance. Consequently, it is no longer necessary to attempt to lift the corporate veil as against these officers in criminal proceedings.

Persons convicted of offenses under the Trade Marks Act may be ordered by the court to forfeit to the government all articles or goods by means of or in relation to which the offense was committed.

ii. Offenses under the Consumer Protection (Trade Descriptions and Safety Requirements) Act

It is an offense under the Consumer Protection (Trade Descriptions and Safety Requirements) Act (Cap. 53) (CPTDA) to apply a false trade description to any goods, or to supply any goods to which a false trade description has been applied. A false trade description under the CPTDA includes a trade description that is false or likely to mislead in a material respect as regards the goods to which it is applied or in connection with which it is used. Counterfeit goods are generally assumed to be goods to which false trade descriptions have been applied. The offense carries a fine of up to S$10,000 and/or a prison term of up to two years.

Similar to offenses under the Trade Marks Act, where an offense under the CPTDA committed by a body corporate is proved to have been committed with the consent and/or connivance of, or be attributable to any neglect on the part of any director, manager, secretary or other similar officer of the body corporate, he or she, as well as the company, will be guilty of the offense and liable to punishment.

iii. Offenses under the Copyright Act

Offenses under the Copyright Act include the sale, hire, making for sale or hire, public exhibition for purposes of trade, and commercial importation into Singapore of infringing copies of works in which copyright subsists. Possession and importation into Singapore of infringing articles for the purpose of sale, hire, distribution or public trade exhibition are also offenses under the Copyright Act. The presumption of possession for purposes of sale applies to possession of five or more infringing copies.

The penalties for these offenses include a fine of up to S$10,000 for each infringing article (up to a maximum aggregate of S$100,000) and/or imprisonment of up to five years.

In addition, possession of an article specifically designed or adapted for making infringing copies of marks is an offense punishable by a fine of up to S$20,000 for each such article and/or a prison term of up to two years.

Further, criminal liability has been extended to ordinary users if the infringement of the copyright is willful and (i) the extent of the infringement is <u>significant</u>; and/or(ii) the person does the action to obtain a <u>commercial advantage</u>. The penalty for the offense is a fine not exceeding S$20,000 and/or imprisonment of up to six months for the first offense. Subsequent offenders face heavier penalties. The penalty for a second or subsequent offense is a fine not exceeding S$50,000 and/or imprisonment of up to three years.

According to the Copyright Act, “significant” infringement is judged based on the volume and value of infringing copies, whether the infringement has a substantial prejudicial impact on the owner of the copyright, and all other relevant matters. It is also provided that a person does an act for the purpose of obtaining a commercial advantage if the act is done to obtain a direct advantage, benefit or financial gain for a business or trade carried on by him or her.

Persons charged with offenses under the Copyright Act may, whether they are convicted of the offenses or not, be ordered by the court to deliver up to the copyright owner the infringing copies of the work or articles specifically designed or adapted for making such infringing copies in their possession. Alternatively, the court may order that the same be destroyed or otherwise dealt with in such manner as the court thinks fit.

Where an offense is committed by a company with the consent or connivance of its director, manager, secretary or other similar officer, he or she, as well as the company, will be guilty of the offense and liable to be proceeded against accordingly.

iv. Offenses under the Registered Designs Act (Cap. 266)

It is an offense for any person to make a false entry in the register or to tender in evidence that false entry, knowing it to be false. The penalty on conviction is a fine not exceeding S$50,000 and/or imprisonment for a term not exceeding five years.

Any person who falsely represents that a design applied to any article is a registered design or marks any article to which the rights to a registered design has already expired with the work “registered” shall be guilty of an offense, and if convicted, shall be liable to a fine not exceeding S$10,000 and/or imprisonment for a term not exceeding 12 months.

Where an offense is committed by a company with the consent or connivance of its director, manager, secretary or other similar officer, he or she, as well as the company, will be guilty of the offense and liable to be proceeded against accordingly.

v. Ex-officio Enforcement Actions

Notwithstanding the private prosecution regime for trademark and copyright offenses, the Intellectual Property Rights Branch (IPRB) of the Singapore Police Force may also undertake *ex-officio* or independent investigations and criminal prosecutions (with the aid of the AGC).

Whether *ex-officio* actions are undertaken by IPRB depends on (among other things):

- the nature of the evidence available;
- the involvement of syndicates;
- the extent of the counterfeiting problem; and
- the public interest.

3. Customs

i. Border Enforcement Measures

As Singapore does not have a customs recordal system, there are no requirements for a notice of IPRs to be provided to Singapore Customs. Singapore Customs is the department within the Immigration & Checkpoints Authority that is designated to exercise border enforcement measures in Singapore.

Under the Copyright Act and the Trade Marks Act, Singapore Customs may seize and take action against goods that are imported into Singapore and that infringe copyright and/or registered trademarks. Proceedings are initiated when the copyright and/or registered trademark owner gives the Director-General of Customs and Excise (the director-general) a written notice if he or she suspects any shipment of infringing goods to be coming into Singapore.

Such notice should include sufficient information to:

- identify the infringing goods;
- enable the director-general to ascertain the time and place of importation; and
- satisfy the director-general that the goods are infringing goods.

Such notice should also include the copyright and/or registered trademark owner's objection to such importation.

Thereafter, Singapore Customs will commence investigations. In addition, the copyright and/or registered trademark owner (i.e., the objector) may be required to deposit a sum of money with the director-general, sufficient to cover the expenses of the seizure before Singapore Customs proceeds with the seizure.

Provided that the notice has been given and has not lapsed or been revoked, Singapore Customs is empowered to search vessels, aircraft, vehicles, persons, baggage and packages and to seize the infringing goods objected to and imported into Singapore. Under the Copyright Act and Trade Marks Act, Singapore Customs now has the authority to examine cargo including "goods in transit" where it reasonably suspects them to be infringing articles. In addition, Singapore Customs may detain any goods that are imported into, or that are to be exported from Singapore, including "goods in transit" so long as the goods are consigned to any person with a presence in Singapore where it reasonably suspects the goods to be infringing articles.

After the seizure, Singapore Customs will notify the objector, who will then be required to institute an action against the importer within the period specified in the notice, failing which the goods may be released to the importer. Upon furnishing the requisite undertakings, Singapore Customs may permit the objector or the importer to remove a sample of the goods seized for inspection.

Failure to take infringement action within the period stipulated in the notice will also give a person aggrieved by the seizure the right to apply to the court for an order of compensation for any loss or damage suffered as a result of the seizure.

Should infringement proceedings be instituted, the court may order the seized goods to be either released to the importer or forfeited to the government for disposal. The objector must, within three weeks of instituting the action for copyright/trademark infringement, obtain a court order preventing the release of the seized goods to the importer. Otherwise, the seized goods will be returned to the importer upon the expiration of three weeks.

From the rights owner's perspective, it is certainly helpful to keep customs informed of any information that counterfeit goods are coming into the Port of Singapore. It will also be beneficial for enforcement actions for the rights owner to have regular communications with customs, so as to be informed if there is any developing trend of counterfeiting activities in relation to any particular brand, so that the rights owner may consider taking the necessary steps to enhance his or her enforcement efforts.

Chapter 3: The Industry's Digital and Online Services Focus – Opportunities and Challenges[1]

I. The Digital and Online World

Fashion and luxury companies traditionally have been reluctant to make use of solutions and functionalities offered by the current digitally enriched environment. The main reason for this is that the digital dimension was perceived as not fitting the values and peculiarities of fashion and luxury brands.

Indeed, it cannot be denied that the online environment is characterized by features such as speed, neutrality and impersonality. These features do not seem likely to be able to respond to customers' expectations: for example, that they will have a tactile experience, and of exclusivity and unicity.

In addition, the digital environment, at least in the beginning, was intended to be limited to selling via the internet and to the social network dimension. The latter, at its embryonic stage, was regarded as a communications tool for the young, not easily adapted to the brands' traditional customers. Selling via the internet was thought to be for mass market goods and services, not fashion and luxury industry products and services.

Technical developments and the establishment of the so-called "web 3.0" dimension, coupled with, and even fostered by, the increasing widespread of mobile tools, which have become an integral part of our everyday life, have given rise to a different scenario.

The evolution of the social network in embracing the social dimension of our society has led to the consequence that "going social" has become inevitable, since customers expect to be able to reach and follow their favorite brands through social media platforms.

Indeed, most, if not all, brands now have a presence on social media, and exploit this as a valuable tool to keep in contact with existing customers and to gain new customers.

Websites and their miniature replications, notably mobile sites, now play a central role as shop windows that customers from anywhere can see at any time. But while the sale of products through e-commerce websites and mobile sites is important, brands have found out that the digital dimension is not always (or not only) about the sale of products, since it may serve also as an effective facilitator to convey messages to existing and prospective customers.

The customer experiehelennce, meaning the values and heritage that a brand represents to its customers and that the brand wishes to share with them, has expanded to embrace the digital environment.

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[1] Francesca Gaudino and Lorenzo de Martinis of the Milan office are the principal authors of this chapter. The country-specific sections were prepared by Ken Chia, Singapore; Anna Gamvros, Paolo Sbuttoni, Ruby Kwok, Hong Kong; Kei Matsumoto, Japan; Lorenzo de Martinis, Francesca Gaudino, Italy; Daniel Sigg, Matthias Scholz, Michael Schmidl, Germany; Magdalena Kogut-Czarkowska, Marek Rosinski, Radoslaw Nozykowski, Marcin Fijalkowski, Dorota Kryszkowska, Poland; Ivan Berdinskikh, Elena Kukushkina, Igor Makarov, Georgy Mzhavanadze, Russia; Raul Rubio, Rosario Alvarez, Spain; Harry Small, Robbie Downing, U.K.; Anne Marie Allgrove, Alethea Giles, Australia; Flavia Rebello, Thais Carvalho, Brazil; Sergio Legorreta-Gonzalez, Mayte Garcia Bulle-Zozaya, Veronique Durand-Rettally, Mexico; Karen Sewell, Brian Hengesbaugh, U.S.

The online presence of a brand may, indeed, serve to lure customers into shops, but shops may also be equipped with forward-thinking technologies that foster online interaction with the brand. Customer engagement and the sale of products are the ultimate goals, and digital tools represent a valuable ally in offering a combined tactile (physical) and virtual experience. This is an unprecedented opportunity that creates in customers the desire to get more involved and in contact with the brand, through different communication channels.

There are many examples of fashion and luxury shops equipped with technology-enriched facilities, such as interactive screens showing live as well as tailored multimedia content, and sales assistants facilitating shopping through smart devices, clothes equipped with smart radio-frequency identification (RFID) tags, etc.

Showing that a brand is technically sophisticated is also an important marketing message for existing and perspective customers. However, technology should serve as a tool for, not dominate, the brand experience.

Given the brand experience is based on the brand's values, heritage and the lifestyle idea that is inherent to it, the digital and online environment represents a new dimension for interaction with customers, which should be considered not an alternative but a complement to the traditional physical dimension.

A. Impact of the Digital World on the Fashion and Luxury Industry

In order to understand the impact of the digital environment on the fashion and luxury industry, it is helpful to highlight certain aspects and the relevant peculiarities of this environment.

Put simply, at the very beginning, the internet represented a potentially unlimited source of information, goods and services.

At a later stage – the so-called Web 2.0 scenario – digital developments mainly involved the user having a new role, of starting to be a producer of the content published online. This stage was the initial interaction of the user with the virtual environment.

The current online era, sometimes referred to as Web 3.0, is characterized by a totally different approach. Viviane Reding, current Member of the European Parliament, pointed out some of the main features of this phenomenon, summed up by, notably, the words "*seamless*", "*anytime" and "anywhere*".

The key word here is probably "seamless", meaning that an individual can enter the virtual world almost without being aware of it, since the digital boundaries are becoming more and more subtle.

The change has been substantial, if you consider that, at one time, to visit a website we would have been sitting at our desks with a (fairly bulky) computer in front of us, and we would have had to type the URL address of the website. Today, we can just touch the screen of our smartphone, or of whatever other mobile device we use.

The obvious consequence is that being connected, entering the virtual world and benefiting from the opportunities that it offers, has become easy, fast and, most importantly, one of many ordinary actions that we do in the course of our day. That is, the virtual dimension is somehow part of our (real) life.

At the same time, it has been observed, the perspective of the social dimension has widened. New social networks have been launched, characterized by different purposes, features and new categories of subscriber types – no more is it only, or mostly, younger people.

1. The Inevitable Trend Toward the Virtual Dimension

The concept of being connected to the internet at any time, through objects other than a traditional computer and no matter where a person was and the time of the day, was first expressed by Mark Weiser back in 1988,[2] with the term "ubiquitous computing".

Now, this is known as the Internet of Things (IoT'),[3] which encompasses features and functionalities of the web that are embedded in objects we usually make use of in our everyday life, ranging from wearable objects (like watches, life bands, trackers and glasses) to so-called domotics (fridges, washing machines, etc.) and to more unusual IoT ecosystems (e.g., the fairly recent phenomenon of connected cars, whose main feature is not just being a comfortable means of transportation but acting as a driver's personal mobile device).

Web 3.0 and the IoT ecosystem are thus based on "smart" objects. Smart objects are built on applications and technology solutions sharing three main features important to understanding the rationale of digital initiatives of fashion and luxury brands:

i. they are meant to collect information from individuals;
ii. they are programmed to share among them the information collected; and
iii. their ultimate goal is to provide products, services and experiences that are customized as much as possible.

Smart objects are the perfect instrument for customer relationship management/customer experience management (CRM/CEM).[4]

B. Peculiarities of Digital CRM and Brand Values

There has been a sharp shift in marketing strategies from a product-centric to a customer-centric approach. In brief, the focus of a promotional campaign used to be the product itself. The message was, in some cases, targeted differently according to the different audiences, yet the main content was the same. This approach has been overtaken by a different way of conceiving the marketing message: its focus has become the customer itself, and the communication has been converted into a conversation with the customer.

Brands nowadays do not contact the customer only to offer a product but, instead, to understand the customer's wishes and desires; the customer is, in a way, the real trendsetter and market driver. There has, e.g., been the "sneakerization" phenomenon: in response to customers' needs, a variety of sneakers, sports and other comfortable shoes have been produced by fashion and luxury brands and become iconic items. A similar trend has been observed in cosmetics, with customers having expressed their desire that their brands produce cosmetics, as part of the brand experience.

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[2] http://www.ubiq.com/hypertext/weiser/UbiHome.html.
[3] http://en.wikipedia.org/wiki/Internet_of_Things.
[4] For ease of reference, we will use the term CRM, meaning both CRM and CEM activities.

Understanding and – as much as possible – anticipating the customer's wishes and desires is considered the competitive battleground for acquiring new customers or retaining existing ones.

Most importantly, this is also the avenue for establishing and building brand values and images. Indeed, CRM is not only about selling a product, it is about selling the brand and fostering the evolution of brand values.

For luxury and fashion companies, the brand itself represents, in fact, the most intangible of intangible assets, yet it is probably the most valuable of the company's assets. CRM is the most suitable tool for a company to maintain and increase its brand value.

The core of CRM is the customer experience, meaning designing and building a customer journey that makes the customer feel happy, with a sense of being respected, served and cared for, according to the customer's expectation. And this experience is meant to last, and be the same, from the very first contact, through to the moment of purchase of brand products, and continuing to post-sale activities and any interaction with the brand. This experience, ideally, should be the hallmark of the whole relationship with the customer.

Of course, a satisfied customer will turn into a loyal customer and, ultimately, a brand advocate. This is probably one of the most effective selling tools, with incomparable potential in terms of market penetration.

Building a great consumer experience is a complex enterprise that starts with comprehensive management of the customer's cross-channel exposure to a brand. Indeed, one of the key features of a successful CRM implementation is the ability to manage multichannel interactions.

The customer may be exposed to the brand either physically (in stores), digitally (through websites), directly, or second-hand (through, e.g., social media, a family member, friends). The must-have approach is that, from the first contact – whatever the channel – the brand translate its values and heritage into consistent experiences at every customer touchpoint.

Web 3.0 instruments answer this call, since they enable seamless and continuous interaction. Through mobile devices and context-aware services, it is possible to keep in contact with customers, using technology to deliver high-value and memorable experiences, anytime and anywhere, and, in this way, brand promises are kept even outside the brick and mortar stores.

Another key factor is that technology allows a one-to-one virtual conversation that works in a bidirectional fashion. That is, the multifaceted options of communication channels may be deployed, on the one hand, to acquire information from the customer, in order better to understand and get to know the customer; and, on the other hand, yet at the same time, to deliver highly customized content.

The last, but definitively not the least, item worth considering is that the Web 3.0 environment is also an efficient incubator of virtual communities and, hence, an accelerator for customers to share their experiences. Of course, a message conveyed through a real-life testimonial is deemed to be much more effective than the most sophisticated yet not personalized marketing campaign. And, most probably, the real-life testimonial will reach the right target.

C. Regulatory Constraints on Digital Opportunities: Europe and Russia, North America, Latin America, the Asia Pacific

A peculiar feature of CRM activities based on new technologies (IoT and web 3.0) is that the reason they are the preferred instrument for conveying brand heritage is the same reason they should be handled with care, given that they might pose serious compliance concerns.

The core of the matter is that CRM (whatever the tools deployed) is literally fed by customer information. This is particularly the case for the fashion and luxury industry, where the ultimate goal is building tailor-made profiles of customers, to get cozier with them on an individual basis, and to maintain an innovative and surprising customer experience.

Concern stems from the fact that customer information is a valuable asset for brands but the privacy of customers is protected by the law; it follows that rules apply to the collection and use of customer information. In some regions, e.g., the European Union (EU), there is a sort of minimum common benchmark in terms of data protection and data security requirements, due to the fact that all Member States' legislation stems from European Directives.[5]

However, transposition into national legislation has occurred in different ways, so that the overall European legislative framework still lacks harmonization and uniformity. This is one of the main drivers behind a draft new regulation on data protection, expected to be issued in the second half of 2015.

It is, therefore, true that specific regulations and limitations vary, sometimes dramatically, from one country to another, but, broadly speaking, the data protection laws set the legal boundaries, and fashion and luxury brands should be aware of the risks of crossing them.

1. Risks of Non-compliance, and Enforcement Trends

This section contains a comparative analysis, covering different countries and geographic areas, of possible risks for non-compliance (e.g., administrative fines, criminal sanctions), according to the applicable legislative framework, and according to the practical experience of our contributors and to relevant enforcement trends (both general ones and, e.g., whether national privacy authorities are, or are not, active in conducting audits, dawn raids and other kinds of enforcement action).

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[5] Directive 95/46/EC of the European Parliament and of the Council of 24 October 1995 on the protection of individuals with regard to the processing of personal data and on the free movement of such data – O.J. L 281, 23 November 1995; Directive 2002/58/EC of 12 July 2002, concerning the processing of personal data and the protection of privacy in the electronic communications sector (Directive on privacy and electronic communication) – O.J. L 201/37, 31 July 2002; Directive 2006/24/EC of the European Parliament and of the Council of 15 March 2006 on the retention of data generated or processed in connection with the provision of publicly available electronic communications services or of public communications networks and amending Directive 2002/58/EC – O.J. L 105/54, 13 April 2006; Directive 2009/136/EC of the European Parliament and of the Council of 25 November 2009 amending Directive 2002/22/EC on universal service and users' rights relating to electronic communications networks and services, Directive 2002/58/EC concerning the processing of personal data and the protection of privacy in the electronic communications sector and Regulation (EC) No 2006/2004 on cooperation between national authorities responsible for the enforcement of consumer protection laws – O.J. L 337, 18 December 2009.

2. Europe and Russia

England

In England, claimants seeking compensation from companies for distress caused by breaches of the Data Protection Act 1998 (DPA) must, to be successful in their claim, continue to establish that they suffered pecuniary loss.

The DPA provision allowing claimants to seek compensation for breaches of the DPA[6] states that the claimant must suffer *damage* as a result of the company's breach of the DPA. The courts in the UK have interpreted *damage* as being limited to pecuniary loss.

If claimant proves pecuniary loss, they might also be able to claim for distress caused by the breach of the DPA. In *AB v MoJ*, the Ministry of Justice (MOJ) was being sued for failing to respond adequately to subject access requests. In that case, a man made a series of subject access requests to the coroner, following his wife's tragic death, and, it seems, MOJ did not handle them according to the DPA. The court acknowledged that he had suffered pecuniary loss but had *"not sought to quantify his time or expense"*, and awarded him nominal damages of £1 to compensate him for pecuniary loss before awarding him £2,250 for the distress he suffered.

The rarity of damages cases for breaches of the DPA suggests there is limited real risk for companies. However, if such a case arises, absent a broadening of the interpretation of the DPA, or a subsequent relevant law being enacted, the *AB* case suggests that the courts will continue to hold that any compensation for distress will only be awarded where the claimant can establish pecuniary loss.

Recently, fines issued by the UK data protection authority, the Information Commissioner's Office (ICO), for breaches of data protection laws have been successfully appealed. In August 2013, the First Tier Tribunal, the first court that fines are appealed to, overturned a fine of £250,000 issued by ICO to the Scottish Borders Council for breach of the DPA. This was in relation to an incident where paper records regarding pension scheme information, which contained personal data, were discovered by a member of the public, because they had been incorrectly disposed of in a supermarket recycling bin.

In October 2013, the First Tier Tribunal overturned a fine of £300,000 issued to an individual in relation to the sending of unwanted text messages in breach of the Privacy and Electronic Communications Regulations. ICO appealed the First Tier Tribunal's decision.

The Upper Tribunal, the court that First Tier Tribunal decisions are appealed to, stated that ICO must be able to demonstrate that the affected individuals suffered substantial damage or distress, rather than mere annoyance, to support enforcement action. The court upheld the First Tier Tribunal's decision to overturn the fine against the person subject to the enforcement action.

The key point for companies is that, even if they are subject to enforcement action, ICO, in addition to establishing knowledge of the act, must be able to demonstrate that the company caused the affected individuals a high standard of distress.

On 15 July 2014, ICO published its annual report, explaining details of key enforcement trends for 2013–14. The report showed that retail companies receive a consistently low number of complaints relating to the processing of personal data.

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[6] Article 13 of the DPA.

In the years 2012–13 and 2013–14, 2 percent of complaints received by ICO related to retail companies. The three main reasons for customers complaining were:

i. data subject access requests;
ii. disclosure of data; and
iii. inaccurate data.

France

Failure to comply with the French regulatory constraints on data protection may result in criminal and administrative sanctions.

The French Data Protection Authority (CNIL) has an important power of sanction. It supervises compliance with the French Data Protection Act[7] (FDPA), by inspecting IT systems and applications. CNIL makes use of its inspection and investigation powers to look into complaints, and may pronounce sanctions, such as a warning that can be made public, against data controllers who do not comply with the FDPA.

On 24 May 2012, CNIL pronounced a public warning against the "Syndicat National des Maisons de Ventes Volontaires" (SYMEV), a professional organization that officially represents auction sales to public authorities.[8] SYMEV had produced a file listing defaulting contractors – i.e. those who had not paid the amount of the contract notes of properties acquired at auction. As this black list likely to exclude people from the right to participate in auctions, its implementation needed to be authorized by CNIL, pursuant to article 25-I-4 of the FDPA. SYMEV did not comply.

Moreover, the collection and processing of the personal data by SYMEV were conducted without providing the mandatory information to the individuals whose data was processed.

The final issue was that the period of data retention adopted was for several years (six years for some files), and such a period was considered to exceed the period for which the purpose of the processing was legitimate. The general rule on data retention is that personal information may be kept only as long as it is necessary to achieve the purpose for which that information had been originally collected and used.

When CNIL issues a formal notice and the data controller does not comply with it, CNIL may:

i. issue a financial penalty – except in the case of data processing performed by government agencies/entities – of a maximum amount of €150,000. This threshold may be increased up to €300,000 for repeated offenses; and
ii. order the publishing of its decision in the press.

For example, on 22 July 2014, CNIL issued a sanction of €5,000 against the company LOC CAR DREAM, specializing in luxury car rentals.[9] The company had set up a geo-localization tool in each available car on a 24/7 basis, and it did not comply, in particular, with its obligation to duly inform individuals whose personal data was to be processed of the conditions of such

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[7] Law of 6 January 1978, and the following amendments and integrations.
[8] CNIL's decision is available at: http://www.legifrance.gouv.fr/affichCnil.do?oldAction=rechExpCnil&id=CNILTEXT000025972614&fastReqId=590849442&fastPos=3.
[9] The decision is available at: http://www.legifrance.gouv.fr/affichCnil.do?oldAction=rechExpCnil&id=CNILTEXT000029298773&fastReqId=726847997&fastPos=1.

processing, and it also failed to fulfill its obligation to implement security measures in order to protect the personal data that was processed.

CNIL could:

i. issue an injunction to stop the processing, which prevents the infringing company making further use of the data that is in breach of the law; and
ii. withdraw an authorization it has previously granted.

In the case of a serious and immediate violation of rights and freedoms of an individual, CNIL may request, through an urgent court hearing, that the competent court order any necessary security measures.

CNIL can also report to the Public Prosecutor of the Republic any violation of the FDPA.

There are specific sanctions for non-compliance with email marketing regulations (i.e., spam – unsolicited, undesired or illegal email messages). The principle governing the sending of marketing ads to consumers in France is the "opt-in" procedure, which entails that the data controller and/or its partners shall individually collect consumers' consent prior to the sending of any marketing communications (article 34-5 of the French Code of post and electronic communication ((CPEC)).

In the case of non-compliance with the CPEC, possible sanctions are:

i. a fine of €750 per each message sent;[10]
ii. five years imprisonment and a fine of up to €300,000 for an individual, and a fine of up to €1,500,000 for a legal entity;[11] and
iii. a fine of up to €300,000.[12]

There is an exception to the "opt-in" procedure, which applies when the following conditions are met:

i. the data controller has obtained a person's details in the course of a sale, or negotiations for a sale of a product or service;
ii. the subject matter of the messages is in relation only to the marketing of products or services similar to those earlier provided to the person; and
iii. the person is given an opportunity to refuse receiving marketing communications at the time personal details are first collected, and provided the person does not opt out at this point, and is always provided with the opportunity to opt out in a simple way, which is made available in any future marketing messages.

We emphasize that most of the issued sanctions may be made public, which may affect a brand's image and, hence, seriously impact the reputations of fashion and luxury companies.

Regarding audit powers and trends in France, it should first be stated that CNIL does have investigative powers. The report on CNIL activity for the year 2013 highlights the following:

- 414 controls performed – including 130 video-surveillance audits;
- 57 formal notices issued – including four public notices;
- 14 sanctions issued – including seven financial sanctions; and
- five warnings issued – including two public warnings.

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[10] Article R.10-1 of the CPEC.
[11] Article 226-18 of the French Criminal Code (regarding unfair collection) and article 226-18-1 of the French Criminal Code (non-compliance with the right to object).
[12] This sanction may be issued by the CNIL, article 47 of the FDPA.

In general terms, CNIL has the following investigative powers:

- right to access data forming the subject matter of processing operations;
- right to collect all the information necessary for the performance of its supervisory duties; and
- effective powers of intervention, such as delivering opinions; ordering the blocking, erasure or destruction of data; imposing a temporary or definitive ban on processing; warning or admonishing the data controller; or referring the matter to national parliaments or other political institutions.

Impeding CNIL in performing its investigative powers shall be sanctioned by up to one year's imprisonment and a fine of €15,000.[13]

Furthermore, the FDPA also grants CNIL after-the-fact control prerogatives, including:

- to pronounce administrative remedies, warning notices, fines of up to €150,000, depending on the seriousness of the infringements, and fines of up to €300,000 or 5 percent of turnover in the event of repeated offenses;
- in an urgent matter, when the data processing implementation infringes freedoms and rights protected under the applicable legislation, to pronounce provisional sanctions, e.g., the interruption of the data processing; and
- when the freedoms and rights protected under the applicable legislation are infringed, CNIL may institute summary proceedings to obtain temporary measures ensuring the safeguard of said freedoms and rights.

The 2014 inspection program of CNIL illustrates the priority given to online inspections, cookies, banking data security and electronic communications operators.

Germany

In Germany, most of the laws that focus on e-commerce are applicable in the "digital" and the "offline" world. Therefore, when thinking about conducting business in the digital world, several laws have to be taken into account, e.g.:

- the Federal Data Protection Act (FDPA), which regulates the collection, processing and use of personal data;
- the Telemedia Act, which contains provisions regarding information obligations and data protection for telemedia services (including online stores);
- the Act Against Unfair Competition, which contains, *inter alia*, provisions regarding direct marketing and telemarketing;
- the German Civil Code, which regulates standard business terms and other consumer protection matters; and
- the German Act on Authors of Art (*Kunsturhebergesetz*), which regulates the publication of photos that show individual persons.

Most of the above-mentioned laws contain provisions regarding enforcement and the results of non-compliance, ranging from criminal or civil proceedings to administrative actions and fines.

[13] Article 51 of the FDPA.

Criminal sanctions for data protection violations in the context of conducting a sound e-commerce business are very rare. Under the German Criminal Code, a violation of data privacy may constitute a crime under certain (exceptional) circumstances: e.g. when sensitive personal data, such as information on medical treatment, is revealed.

However, and which is, practically speaking, more likely, monetary fines may be imposed by data protection authorities (DPAs) on companies that infringe data protection law. Past experience shows that DPAs will first order the controller to cease and desist from the infringing activities. Amending running systems to comply may, alone, lead to significant costs (e.g., for developing changes to existing CRM systems), which constitute a burden on the business responsible.

In addition, selected third parties, e.g., consumer protection bodies and competitors, may demand cease-and-desist undertakings from businesses that violate laws, e.g., the direct marketing provisions of the Act Against Unfair Competition or the provisions regarding standard business terms in the German Civil Code.

Finally, individuals whose rights have been infringed may equally claim for damages and/or have a right to bring a cease-and-desist claim before the courts. Moreover, the German public – particularly the German media – tends to be very concerned about privacy, and a data protection violation may lead to public uproar and a loss of reputation and consumer confidence.

Regarding the private sector, in total there are 17 DPAs in Germany, one in each of the 16 states (*Länder*), and a DPA at the federal level that regularly makes recommendations regarding the interpretation of the FDPA. They all apply the FDPA when dealing with private sector companies.

From state to state, funding and staffing of the DPAs differ. Even their status of independence may differ: in some states, they are a subordinate department of a ministry; in other states, they are independent of government and their head is elected by the parliament.

Some DPAs are more active than others. To a large extent, they audit companies, and these audits are often launched in reaction to complaints of individuals. Audits usually consist of requests to complete questionnaires but may also include visits to the companies' premises and interrogations.

If a DPA identifies a breach of the FDPA, it will most likely try to reach a consensual solution. The FDPA expressly states that DPAs should provide advice to companies and to data protection officers of companies. However, the DPA can, at any time, issue a binding administrative order to stop the infringement. If such an order is not observed within a reasonable time, the DPA may enjoin the company from further collecting or processing personal data for as long as the infringement persists. In some cases, the economic loss of such orders is high: e.g., if systems must be reprogrammed, or a business model changed or shut down completely.

Fines are regularly imposed on companies in the case of material infringements of the FDPA. Although most DPAs focus on helping businesses comply with the FDPA, they have the power to impose high fines. There is a statutory limit of €300 for fines; however, the DPA may go beyond this limit, if necessary, to skim the financial benefit derived from an infringement.

Since the DPAs investigate in many different industries, they sometimes focus on specific issues in order to create a general awareness of particular data protection matters that are relevant to the industry and/or to refine the legal framework that applies to individual business models. For example, the DPA in the state of Schleswig-Holstein often audits social media presentations, and the Bavarian DPA recently ran a campaign about the security of email servers.

DPAs have been focusing on clothes when they are first equipped with RFID. In order to create awareness regarding data protection, they may also focus on "wearable" computing, if it becomes more prevalent and information sent out by wearables becomes part of the information processed in the context of the IoT.

Italy

Italy enacted the first data protection law, back in 1996,[14] so it may be said that it has a fairly mature legislative framework, in terms of data protection and data security requirements. The main piece of legislation to be taken into account is Legislative Decree 196 of 30 June 2003, and the following amendments and integrations (the Privacy Code), which has updated the provisions contained in the former Italian privacy law and provided material changes and enhancements. Furthermore, the Privacy Code has enforced the European privacy Directives[15] that were not enacted by the former privacy law, and also contains provisions relating to codes of conduct, as well as case law precedents of the Italian Data Protection Authority (Garante).

Regarding the proposed sanctioning structure, the Privacy Code provides for administrative and civil sanctions; under limited circumstances, criminal sanctions may also apply. The sanction depends on the specific privacy rule that is breached. Below is a list of the sanctions issued in relation to the most common breaches – a fine ranging from:

i. €6,000 to €36,000 for failure to comply with the information requirements for the data subject;
ii. €50,000 to €300,000 in the case of several violations, as well as for different periods of time and regarding particular databases;
iii. €10,000 to €120,000 for lack of adoption of minimum data security measures; and
iv. €30,000 to €180,000 for failure to comply with orders and provisions of the Garante.

Some of the above sanctions may be decreased to two-fifths in the case of less serious violations, and in the case of more serious breaches or of the breach affecting a material number of data subjects, the Garante may increase the fine by up to two times or four times, if deemed appropriate, taking into consideration the economic capacity of the infringer.

Failure to obtain the consent of the data subject, when necessary, may trigger a criminal sanction of imprisonment for up to three years. Criminal sanctions may be applied if the data-processing activities are proved to have been carried out by the infringer with a view to gain for itself, or for another, or with an intent to cause harm to another, if harm is caused.

Civil liability, namely the obligation to compensate with monetary and also moral damages, applies in any case when data processing causes damage to the person/entity whose data is processed, and is in breach of the general principles set out by the Privacy Code in relation to lawful data processing.

Furthermore, an administrative sanction, consisting of publication of the injunctive order, in whole or in part, in one or more newspapers as specified in the relevant order of the Garante, may also be applied.

[14] Law 675 of 31 December 1996.
[15] For example, Directive 2002/58/EC – the so-called eDirective; and Directive 2009/136/EC – the so-called Cookies Directive.

An additional measure usually ordered by the Garante is the block of the affected databank. This blocking order means that the relevant databank may no longer be used for any purpose, save for activities necessary to comply with the applicable laws and contractual obligations.

Generally, it may be said that criminal sanctions are applied in limited circumstances, while administrative fines and compensation with monetary and also moral damages, in the case of civil liability, are very commonly applied.

Regarding enforcement actions and trends, the Garante is fairly active in carrying out investigations and on-site audits. These may be initiated at the Garante's discretion, or may be triggered by complaints filed by data subjects or third parties. On-site audits may be performed either at the legal office or the place of business of a company – i.e., in the case of fashion and luxury companies, the Garante may perform an audit at a legal office or at a shop.

The 2013 annual report of the Garante[16] states that fines have been issued for a total amount higher than €4 million and that 411 inspections have been carried out. The breaches sanctioned have most often been:

i. failure to provide appropriate information to the data subjects;
ii. unlawful data processing;
iii. breaches of orders and provisions of the Garante; and
iv. failure to comply with opt-out obligations in relation to marketing activities.

In addition, it should be mentioned that the Garante is fairly active in taking part in international activities and joint initiatives organized with other European data protection authorities and with international authorities.

Poland

In general, the Polish General Inspector of Data Protection (DPA) does not impose fines other than for non-compliance with its final decisions. Generally, such fines would not exceed, in total, €12,000 for a natural person or €50,000 for a legal entity.

Failure to comply with data protection laws can result in complaints, DPA investigations/audits, orders (such as an order to remove all databases), civil actions, and criminal proceedings and/or private rights of action.

Additionally, if a certain online practice is viewed by the President of the Office for the Protection of Consumers and Competition (Consumer Office) as a breach of the collective consumer rights, the Consumer Office may impose large fines, of up to 10 percent of revenues from the year preceding the year of the decision imposing the fine.

Finally, it should be noted that the imposition of the sanctions mentioned above could also trigger reputational damage for the company.

The Poland DPA is moderately active in enforcement activities. In 2013, it issued over 1,300 administrative decisions. Of the decisions issued in 2013, 74 were issued in connection with audits carried out by DPA and 646 were issued as a result of proceedings initiated by a complaint.

Spain

In Spain, the fines that may be imposed due to a breach of the data protection legislation range from €600,000 to €900,000, depending on the seriousness of the infringement.

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[16] The annual report of the Garante is available in Italian on the relevant website, at: www.garanteprivacy.it.

However, companies can also be sanctioned due to breaches of the legislation on information society services and e-commerce, which regulates commercial communications and cookies, among other matters. By way of example, the sanctions that may be imposed due to a breach of the provisions on commercial communications may be as high as €150,000. Other sanctions are set out in the consumer legislation.

It should be noted that not all sanctions consist of fines; indeed, companies may have imposed on them, e.g., temporary closure of their establishments, confiscation of merchandise, or publication of the issued sanctions.

In addition to the above, the issuing of a sanction may trigger reputational damage for the company, and in Spain it is common for the media to cover cases of well-known companies that have high fines imposed on them. In the case of data protection infringements, and even if sanctioning resolutions are published on the relevant website, it is common for the Spanish Data Protection Agency (SDPA) specifically to highlight landmark cases.

SDPA is a very active body and, generally, imposes the highest number of sanctions in Europe. According to the Memorandum of SDPA for 2012,[17] the total sum of the fines imposed by it that year was €21,054,656.

The sanctions imposed by SDPA are not only a consequence of claims filed by affected data subjects, as it also carries out *ex officio* inspections that may result in sanctioning procedures. In addition, SDPA participates in actions managed by international bodies, such as the international privacy sweep of mobile apps conducted by the Global Privacy Enforcement Network (GPEN) in May 2014.

Russia

In Russia, illegal collection and processing of personal data may result in civil, administrative and even criminal liability. The burden of proof in relation to the consent of individuals lies with the recipient of the relevant information.

Regarding civil liability, an individual may claim recovery of damages caused, including direct damages, lost profits and moral damages. However, it is the claimant's burden to prove the breach, the damages and the causal link between them. In practice, it would be quite difficult for an individual to meet such a burden of proof. As far as moral damages are concerned, the Russian courts are not very supportive of such compensation.

Regarding administrative liability, pursuant to article 13.11 of the Code for Administrative Violations (the Code), for violation of the procedure for acquisition, storage, use, or dissemination of personal data, officers of an operator (the company) may be subject to a fine of RUB500 to RUB1,000 (approximately US$15-30) and/or the company may be subject to a fine of RUB5,000 to RUB10,000 (approximately US$150-300).

Violation of rules on protecting information is punishable under article 13.12 of the Code. Thus, e.g., violating the terms and conditions stipulated by a license for exercising activities in the area of information protection (except for information constituting a state secret) shall entail the imposition of an administrative fine on citizens of RUB1,000 to RUB1,500 (approximately

[17] The Memorandum is available in Spanish on SDPA's website at: https://www.agpd.es/portalwebAGPD/index-ides-idphp.php.

US$30-45), on officials of RUB1,500 to RUB2,500 (approximately US$45-75), and on legal entities of RUB15,000 to RUB20,000 (approximately US$450-600).

Using uncertified information systems, databases and data banks, as well as uncertified means of information protection, where they are subject to obligatory certification (except for the means of information protection constituting a state secret) shall entail the imposition of an administrative fine of RUB1,500 to RUB2,500 (approximately US$45-75), with or without confiscation of uncertified means of information protection; on officials, an administrative fine of RUB2,500 to RUB3,500 (approximately US$75-105); and on legal entities, an administrative fine of RUB20,000 to RUB25,000 (approximately US$600-750), with or without confiscation of uncertified means of information protection.

Also, a violation of information protection license conditions shall entail the imposition of an administrative fine on responsible officers or employees of RUB2,000 to RUB3,000 (approximately US$60-90), and on legal entities, of RUB20,000 to RUB25,000 (approximately US$600-750) or the administrative suspension of activities of the legal entity for a term of up to 90 days. A gross violation of information protection license conditions may entail administrative suspension of activities of the legal entity for up to 90 days.

Under article 13.14 of the Code, disclosing limited access information (including personal data) by a person who obtained access due to the performance of relevant official duties shall entail the imposition of an administrative fine, on citizens, of RUB500 to RUB1,000 (approximately US$15-30), and on officials, of RUB4,000 to RUB5,000 (approximately US$120-150).

It is important to note that if the responsible officer or CEO is a foreign national, the imposition of an administrative fine may jeopardize the relevant Russian work permit and visa status.

Lastly, taking into account criminal liability, illegal collection or dissemination of information on an individual's private life, without the individual's consent and committed with the use of official capacity, may be subject to:

i. a fine for the relevant operator's officer of up to RUB300,000 (approximately US$9,000);
ii. a fine in the amount of the relevant salary or other income for up to two years;
iii. prohibition on holding certain positions for two to five years;
iv. compulsory labor for up to four years, with or without prohibition on holding certain positions for up to five years;
v. arrest for up to six months; or
vi. imprisonment for up to four years, with or without prohibition on holding certain positions for up to five years.

Only individuals proved to be guilty are subject to criminal liability under Russian law, and this requires proving direct intent on the part of the guilty person.

The Federal Supervision Agency for Information Technologies and Communications (Roskomnadzor) is the primary data protection authority in Russia. In particular, Roskomnadzor is authorized to:

i. impose administrative sanctions for violation of data protections laws;
ii. initiate inclusion of any website violating personal data requirements on the special register of prohibited information (any access to such websites via Russian providers shall then be blocked);
iii. conduct compliance audits and inspections;
iv. file court claims for the protection of the general public, etc.

Due to recent political trends in Russia, Roskomnadzor has become a very active body, with a large and increasing range of powers.

3. North America

The United States

A patchwork of, sometimes overlapping, federal and state laws and regulations may impact how digital CRM initiatives are rolled out in the U.S.

At the federal level, the Federal Trade Commission Act (FTC Act), administered by the Federal Trade Commission (FTC), prohibits unfair and deceptive trade practices.

The U.S. CAN-SPAM Act, also administered by FTC, regulates email marketing to consumers and business customers.

The US Children's Online Privacy Protection Act (COPPA) regulates the online collection of personal information from children under the age of 13, and has strict notice, parental consent, security and procedural requirements. COPPA also restricts the manner and types of advertising directed to children under the age of 13 on child-directed sites.

At the state level, so-called mini FTC Acts have similar prohibitions against unfair and deceptive trade practices.

Many states also have strict data security laws requiring certain security procedures to be implemented and that service providers apply comparable security terms. California also has specific laws applying to the online collection of personal information from California residents. Given the size and importance of the California market, these laws are broadly applied to websites operating in the U.S.

The California Online Privacy Protection Act (CalOPPA) requires that websites collecting personal information post a privacy policy addressing specific content requirements. The California Shine the Light Act, which applies to both online and offline marketing activities, imposes specific disclosure and reporting obligations on companies that share their customers' personal information with affiliated and unaffiliated third parties for their own marketing purposes.

To the extent personal information collected online is used to contact customers by phone or postal mail, additional federal and state law requirements, which are beyond the scope of this chapter, may apply.

Taking into consideration enforcement trends, FTC and the California Attorney General are the two most active U.S. government agencies on privacy enforcement.

Recent areas of enforcement focus include ensuring appropriate disclosures of privacy practices for mobile applications, ensuring compliance with COPPA on general audience websites that knowingly collect personal information from children under the age of 13, and holding companies to their representations regarding the level of security being used on their sites.

From a policy perspective, FTC has been focused on the trends of big data and data brokers and how these affect the privacy of U.S. consumers.

4. Latin America

Brazil

The main regulatory constraints on the online selling of products and rendering of services in Brazil are those regarding the consumer relationship, and, where applicable, the provisions of the Internet Legal Framework.

The Consumer Defense Code (CDC) is a protective law with principles and duties intended to look after the "vulnerable party" (i.e., consumers). It provides general guidance on many aspects that are also applicable to e-commerce, mainly issues related to the right of information, advertising, abusive practice, cooling-off periods, warranties (implied and contractual), limitation of rights, etc. The CDC and related provisions are based on the duty of transparency, which means that suppliers must use very clear terms that could be easily assessed, identified and understood by all consumers. Most of the claims related to non-compliance with the CDC requirements arise from allegations of absent or misleading information during the whole process of e-purchase (notably pre and post purchase).

Accordingly, a new decree[18] regulating e-commerce activities in Brazil (the new E-Commerce Regulation) was enacted in 2013. The e-commerce rules deal specifically with consumer protection in the e-commerce environment, imposing several obligations on suppliers, including the use of efficient safety mechanisms for data storage.

Accordingly, the new E-Commerce Regulation provides a series of obligations for suppliers of products/services online to comply with in order to enhance e-commerce activities in Brazil and to secure the protection afforded to Brazilian consumers under the CDC. The main purpose of the new E-Commerce Regulation is to oblige online suppliers to provide clear information regarding the products and services offered for sale, as well as about the supplier itself, to enable an easy customer service channel and to secure the consumers' right to a cooling-off period, as provided for in the CDC.

Penalties for non-compliance with the provisions of the CDC and, more specifically, e-commerce rules, include, but are not limited to:

i. fines;
ii. cancellation of product registration with the competent authorities;
iii. prohibition on manufacturing the product;
iv. suspension of product or service supply;
v. temporary suspension of the activity;
vi. revocation of concession or permission to use;
vii. cancellation of license for the establishment or activity;

[18] Decree No. 7,962/2013.

viii. total or partial closing down of the establishment, work, or activity;
ix. administrative intervention; and
x. imposition of counter-advertising.

Such penalties may be applied cumulatively. The most common sanction is a fine, but consumer authorities have been using alternative sanctions against companies that operate on the internet, such as temporary shutdown of websites in cases where there have been a considerable number of consumer complaints.

Finally, it is very common for Brazilian consumers to express their discontent with products or services online. In fact, there are several blogs specializing in sharing consumers' opinions and testimonials about products they have bought or services they have retained. This has been increasing, through the use of social media networks.

Such blogs may organize complaints by category, company, subject, etc., and sometimes even rank the companies that receive the highest numbers of complaints. Please note, though, that such blogs usually allow suppliers to respond to such complaints and solve customers' problems. Therefore, while such online platforms may increase a supplier's exposure and, as a result, give rise to reputational damages, they are also a valuable tool to strengthen relationships with clients, and an important channel for solving any issues in a more expedited manner, which may also reduce the chance of lawsuits.

Brazil has no data protection authority. Accordingly, it is up to the Brazilian courts, on a case-by-case basis, to enforce any actions relating to data protection issues.

Mexico

During its second year as a data protection authority, the Federal Institute for Access to Public Information (IFAI) ruled on 18 cases and imposed record-high penalties, in a total amount of 4.3 million dollars, on various companies. The sanctions take into account intent, economic capacity, severity of conduct and backsliding. It is worth mentioning that, in certain cases, civil and criminal responsibility may also be triggered.

The main grounds for the latest fines were:

i. unauthorized transfers of data to third parties;
ii. failure to obtain consent regarding collection and/or transfer of personal data;
iii. failure to inform data subjects regarding the available mechanisms to manage the requests of enforcement of individuals' rights;
iv. collection and processing of financial data without obtaining express consent from data subjects; and
v. general obstruction of justice.

Regarding recommendations on security measures to protect personal data, please note that, on 30 October 2013, IFAI issued "Recommendations regarding Security Measures to Protect Personal Data" (Recommendations'). While these Recommendations are not mandatory, organizations that implement security management models in line with them will be afforded regulatory benefits, including reduction of fines. The Recommendations offer a regulatory reference and legal certainty for IT departments regarding controls and measures that should be implemented to protect personal data.

IFAI is becoming stronger and, consequently, more active. Back in November 2013, the Mexican Congress approved a bill that included the removal of IFAI and the creation of a new constitutional autonomous agency.

Under the Federal Data Protection Law (FDPL), organizations may develop and implement so-called self-regulation schemes. These include codes of ethics, professional practice codes, privacy policies, corporate privacy rules, binding corporate rules and certifications, where appropriate. Organizations must file their self-regulation schemes with the competent authority in order to obtain an official registration. Organizations can greatly benefit from obtaining registration, particularly regarding the imposition of fines in the case of infringement.

In March 2013, IFAI issued regulations regarding video surveillance. Pursuant to these rules, data controllers that carry out video surveillance in their facilities must comply with the information principle by placing privacy notices within the areas that are under surveillance. IFAI has highlighted that, to the extent video surveillance technologies are capable of identifying voices and images of individuals, they could be highly invasive. Data controllers should take a proactive approach and clearly provide information about the use of these technologies.

5. The Asia Pacific

Australia

Australia is a mature jurisdiction in relation to privacy law and has had privacy legislation in place since 2000. The key legislation regulating privacy in Australia is the federal Privacy Act 1988 (Cth) (Privacy Act). Significant amendments to the Privacy Act came into effect on 12 March 2014, including the introduction of 13 harmonized privacy principles – the Australian Privacy Principles (APPs) – to regulate the collection, handling, use and disclosure of a data subject's personal information.

Some states and territories also have privacy legislation and/or administration guidelines that apply to their public sector (i.e., government departments and agencies, etc.) or in relation to health information and human rights legislation, which includes the right of individuals not to have their privacy interfered with unlawfully or arbitrarily.

The risks for non-compliance with the Privacy Act include investigations and audits by the regulator, injunctions and enforceable undertakings in relation to certain behaviors, reputational damages and breach of data subjects' trust. In addition, the Federal Court can issue fines for non-compliance with specific provisions of the Privacy Act. These fines are a civil, rather than criminal, penalty.

The most significant financial penalty under the Privacy Act applies where an entity undertakes an act or practice that is a serious interference with the privacy of an individual, or repeatedly interferes with the privacy of one or more individuals. In these cases, the Federal Court may issue an organization with a maximum fine of A$1,700,000 (approximately US$1,400,000) for each interference. An individual may be subject to a maximum fine of A$340,000 (approximately US$280,000) for each interference. There are also aiding-and-abetting offenses.

When considering the penalty, the court will take into account the nature and extent of the contravention, the nature and extent of any loss or damage suffered because of the contravention, the circumstances in which the contravention took place, and whether the court has previously found that similar conduct has taken place.

Additional consequences or penalties may apply under other Australian laws, including the Australian Consumer Law (ACL). The ACL prohibits a person, in trade or commerce, from engaging in conduct that is deceptive or misleading, or is likely to deceive or mislead. This is particularly applicable to digital operations where an organization or individual engages in conduct that is, or is likely to, mislead or deceive customers in relation to the collection, use or management of their personal information.

The consequences of a breach of this type may include enforceable written undertakings (which may attract compensatory orders or a fine if not complied with). The ACL regulator may issue a public warning notice in relation to the organization's conduct, and/or the Federal Court may issue an injunction for the organization to take some specific actions. A person who has suffered loss or damage due to a contravention of the misleading and deceptive provisions of the ACL may seek to recover such loss or damage against anyone involved in the contravention.

Regarding enforcement trends in Australia, the Office of the Australian Information Commissioner (OAIC), since it was established in 2010, has investigated and dealt with an increasing number of complaints in relation to privacy. OAIC expects that complaints in 2013–2014 will increase by over 100 percent, due in part to heightened awareness by consumers (as data subjects) of recent legal changes to privacy law and their corresponding rights, and the increased communication between businesses and consumers.

Historically, the Privacy Commissioner, through OAIC, has relied on detailed recommendations to businesses and negative publicity as the primary enforcement methods, rather than seeking monetary penalties from the court. The Privacy Commissioner has indicated that OAIC will not "shy away" from using its powers in appropriate cases but considers that its role is to act as an escalation point, rather than becoming involved with data subjects' complaints at the first instance.

As digital commerce and data retention become more widespread, there is likely to be heightened regulatory activity. One of the challenges to this trend, however, is the declining resources being applied to OAIC and its operations. For example, in response to the recent OpenSSL vulnerability (known globally as "Heartbleed"), the Privacy Commissioner stated that the sheer volume of organizations being impacted meant that OAIC would not undertake any assessment or investigation of a particular organization without an allegation that personal information had been lost.[19]

Adding to these financing constraints was the announcement by the Australian Government on 13 May 2014 that OAIC would be disbanded by 1 January 2015. It is anticipated that the responsibilities and functions relating to the Privacy Act will pass to the Privacy Commissioner, who will likely operate through a new statutory body.

OAIC is an independent statutory body with regulatory responsibility for, among other things, compliance with the Privacy Act and the APPs. OAIC comprises the Privacy Commissioner, the Information Commissioner, the Freedom of Information Commissioner, and their staff.

[19] Please see at http://www.zdnet.com/au/heartbleed-too-big-to-investigate-privacy-commissioner-7000028523/.

With the introduction of new powers in March 2014, OAIC can:

i. conduct privacy compliance audits of private sector organizations randomly, or based on a complaint. These audits are intended to assess an organization's performance against the APPs or any relevant privacy codes that apply to that organization;
ii. investigate matters on the basis of a complaint, or on OAIC's own initiative;
iii. for complaint-based matters – conduct preliminary inquiries to obtain further information to determine whether an investigation is necessary and attempt to conciliate complaints;
iv. make determinations at the end of investigations (whether complaints based, or based on the OAIC's own initiative) that:
    a. a person is entitled to a specified amount of compensation for loss or damage suffered by an individual due to the interference with their privacy; or
    b. it would be inappropriate for any further action to be taken;
v. require information or documents to be produced, or a person to attend to answer questions under oath or affirmation; and
vi. seek injunctions for certain behavior.

OAIC's broader enforcement powers include accepting enforceable undertakings from entities that they will take, or refrain from taking, specified action to ensure compliance with the Privacy Act. OAIC may apply to the court to have the undertaking enforced and may publish any undertakings on its website. OAIC may also seek civil penalties in the case of serious breaches of privacy, and conduct assessments of privacy performance for both Australian government agencies and private sector organizations.

The factors OAIC will take into account when deciding to enforce its regulatory powers include the seriousness of the conduct, whether the entity has been subject to previous compliance measures, whether the conduct is an isolated instance, the cooperation provided by the entity, and whether the entity has taken action to remedy and address the consequences of the conduct.

OAIC has also issued guidelines with respect to the operation of the APPs.[20]

China

The first two areas that are addressed below (telecommunications issues and blocking of overseas social media sites) include some general regulatory constraints that may not be directly related to data privacy but are specific to China and that luxury and fashion industry players should be aware of.

Regarding telecommunications issues, luxury and fashion industry players who have their server(s) located physically within the territory of China are subject to recordal requirements. This is also the case if the overseas-based player leases a server located in China, and maintains and updates the content of the relevant website hosted on the server (by itself or through a third-party service provider that takes its instructions). Other permits/approvals may also be required for the operation of a website, depending on the content and scope of services offered on it. However, some of these permits/approvals are currently off limits to foreign direct investment.

In addition, content on the website (whether hosted within or outside the territory of China), including user-generated content, is subject to the jurisdiction of the People's Republic of China (PRC) authorities. If any content on a website is contrary to PRC law and is discovered by, or

[20] Please see at http://www.oaic.gov.au/privacy/applying-privacy-law/app-guidelines/.

brought to the attention of the PRC authorities, they will investigate the PRC entity or subsidiary of the foreign company and may hold that entity or subsidiary liable. Access to websites hosted overseas with content contrary to PRC law may also be blocked in its entirety.

Regarding blocking of overseas social media sites, a number of popular overseas social media sites are officially blocked in China: e.g., Facebook and Twitter. If industry players are promoting/marketing their products/services via social media sites, local social media sites, such as Tencent Weibo or Sino Weibo, should be used instead.

On the issue of prohibited information, PRC law prohibits the production, reproduction, access to and dissemination (including cross-border transfer) of certain information (prohibited information).

Prohibited information is defined vaguely under PRC law, and generally refers to information that may harm the interest of the state, cause social instability or infringe other peoples' rights. Politically or socially sensitive information, such as religious beliefs and political opinions, may also be regarded as prohibited information. An onshore website provider is required to conduct filtering and monitoring of the content displayed on the website on a 24/7 basis. Failure to comply with the statutory requirement on content control can result in a rectification order, suspension of the provision of services, a revocation of license or, in extreme cases, criminal liabilities. On the other hand, access to a website with prohibited information that is hosted overseas may be blocked by the PRC authorities in its entirety.

Taking into account consumer protection issues, it should be noted that the amended Law of the PRC for Protection of Rights and Interests of Consumers (PRC Consumer Protection Law), which came into effect on 15 March 2014, requires business operators who provide goods and services to PRC consumers to explicitly inform the consumers of the purposes, scope and manner of personal data collection and use, and obtain their consent to it.

If a business operator infringes a consumer's rights regarding personal data protection under the amended law, it will be subject to the corresponding civil liability. A rectification order will be imposed, together with one or more of the following penalties:

- issuance of a warning;
- confiscation of the illegal income;
- imposition of a fine of not less than once but not more than 10 times the illegal income; or
- if there is no illegal income, the imposition of a fine of not more than RMB500,000 (approximately US$83,000).

If the circumstances are serious, the business operator will be ordered to cease business and reorganize, and its business license will be revoked.

Regarding the general protection of personal electronic information, it should be noted that, under the Decision of the Standing Committee of the National People's Congress on Strengthening the Protection of Network Information (NPC decision), which came into effect on 28 December 2012, electronic information that identifies an individual and/or relates to the individual's privacy is protected by the state, and obligations are imposed on organizations that collect and use such personal electronic information in their business operations.

Technically speaking, the NPC decision also applies to overseas-based companies that collect and use the personal electronic information of PRC citizens in their business operations.

A person who violates any rules in the NPC decision may be subject to a warning, a fine and/or other administrative penalties (e.g., confiscation of illegal income, revocation of the business license, etc.). If the violation constitutes an offense, the offender will be subject to a criminal penalty. If the violation involves an infringement of an individual's civil rights and interests, the person who is in breach of the rules will be subject to a civil liability.

It should be mentioned that there is no specific legislation on personal data protection or privacy in China. Neither is there any data protection authority in China. As the concept of privacy or data protection exists under various pieces of laws and regulations (such as those mentioned above), the authorities enforcing those respective laws and regulations are also responsible for the enforcement of the privacy-related rules under those laws and regulations.

For instance, under the Criminal Law of the PRC, it is a criminal offense for anyone who works in a government organization or other designated sectors to sell personal data obtained in the course of work. – The Public Security Bureau authorities are responsible for enforcing these rules; the amended PRC Consumer Protection Law imposes obligations on business operators with respect to their collection and use of personal data of PRC consumers; and the Administration for Industry and Commerce authorities are responsible for the enforcement of the relevant rules.

In recent years, the PRC authorities have made a great effort to take enforcement action against persons who illegally sell/provide or obtain personal data. With the increasing awareness by the general public of the need for personal data protection, this is intended to address the growing problems related to the theft and misuse of personal data by unscrupulous individuals/companies who profit from it – the number of data theft/sale incidents is increasing, and, these days, it is not uncommon to uncover large-scale data theft/sale in China.

Hong Kong

The Personal Data (Privacy) Ordinance (PDPO) governs the collection, use, processing, security, retention/destruction of, and access to, personal data in Hong Kong and specifies certain notification and consent requirements.

There are additional requirements applicable to the use of personal data for direct marketing purposes. Indeed, the Unsolicited Electronic Messages Ordinance (UEMO) regulates the sending of unsolicited commercial electronic messages with a Hong Kong link and specifies certain content requirements. Brands may also be liable for any restricted content that is made available on their websites: e.g., obscene or indecent articles under the Control of Obscene and Indecent Articles Ordinance (COIAO), defamatory statements under the Defamation Ordinance, and seditious content under the Crimes Ordinance.

Non-compliance with these requirements may result in a penalty of a fine and/or imprisonment.

Under the PDPO, if the Privacy Commissioner for Personal Data (Privacy Commissioner or "PCPD") suspects breaches of the requirements of the PDPO, it may issue an enforcement notice to a data user, requiring it to rectify the breach. Failure to comply with the enforcement notice may result in a fine of up to HK$100,000 (approximately US$12,900) and imprisonment for up to two years. Non-compliance with the direct marketing provisions of the PDPO carries heavier penalties, under which the offender may be liable for a fine of up to HK$1,000,000 (approximately US$129,000) and imprisonment for up to five years.

Under the UEMO, if the Communications Authority is of the opinion that any person is contravening the rules regarding the sending of commercial electronic messages, it may serve an enforcement notice requiring that person to take remedial action. Failure to comply with an enforcement notice may attract a fine of up to HK$1,000,000 (approximately US$129,000) and imprisonment for up to 10 years.

Under the COIAO, any person who commits an offense may be liable for a fine ranging from HK$400,000 (approximately US$51,600) to HK$1,000,000 (approximately US$129,000) and to imprisonment for a term from 12 months to three years.

In addition, non-compliance may potentially lead to adverse publicity, causing reputational damage and loss of customer trust in the brand.

PCPD is an independent statutory body set up to oversee the enforcement of the PDPO. The Privacy Commissioner oversees the administration of the PCPD and monitors compliance with the provisions of the PDPO. The Privacy Commissioner has the power to investigate suspected breaches of the requirements of the PDPO, and issue an enforcement notice to a data user, requiring it to rectify such breaches. Non-compliance with an enforcement notice can result in fines and/or imprisonment.

At present, investigations by the Privacy Commissioner are mostly based on complaints from the data subjects (e.g., customers). However, we see that the Privacy Commissioner is taking an increasingly proactive role in enforcement, and has published a number of guidelines providing practical guidance for data users about compliance with the requirements of the PDPO.

The Privacy Commissioner also has a "name and shame" policy and will comment publicly on contraventions of the data protection law in Hong Kong.

Earlier this year, the Communications Authority prosecuted a commercial facsimile sender for contravening the UEMO, for the first time since the law came into force, in 2007. The police are also actively engaged in pursuing non-compliance with the COIAO.

Japan

Data protection issues in Japan are regulated by the Act on the Protection of Personal Information (the Act). Under the Act, the competent minister may take administrative measures in the case of non-compliance. It is basically a two-step process (or a three-step process, including the criminal sanction): first, a recommendation is to be issued, and if it is not fulfilled, the order to take the recommended measures is issued. If the order is not fulfilled, a criminal sanction will be applicable under article 56 of the Act.

In addition, each individual may have the right to sue a company mishandling or spilling personal information and therefore infringing their privacy rights. Thus, this infringement leads to the risk of civil litigation (in tort law), although the level of the amount of compensation for damages with regard to this kind of matter is generally low in Japan.

Reputational risk and lost of customer trust can be a serious consequence, if such non-compliance is made public.

There is no specific data protection authority in Japan. Rather, the competent minister has a certain authority and role (e.g., the Minister of Health, Labour and Welfare has the authority and role regarding relevant matters in hospitals).

Under the Act, the competent minister does not have the authority to take strong measures (e.g., audits, dawn raids). The minister, does however, have the authority to collect reports and give advice.[21]

Practically speaking, softer administrative measures (such as advice) are the preferred approach to breaches of data protection regulation in Japan.

Singapore

Data protection matters in Singapore are regulated by the Personal Data Protection Act (PDPA) and the Spam Control Act (SCA).

The PDPA established a general data protection law in Singapore, which governs the collection, use and disclosure of an individual's personal data. In addition, it established Singapore's national Do No Call (DNC) Registry and prescribed the obligations of organizations relating to the sending of certain marketing messages to Singapore telephone numbers.

The Personal Data Protection Commission (PDPC) is tasked with the administration and enforcement of the PDPA. If PDPC finds that an organization is in breach of any of the data protection provisions in the PDPA, it may give the organization such directions it thinks appropriate to ensure compliance.

These directions may include requiring the organization to:

- stop collecting, using or disclosing personal data in contravention of the PDPA;
- destroy personal data collected in contravention of the PDPA;
- provide access to or correct the personal data; and/or
- pay a financial penalty of an amount not exceeding S$1 million (approximately US$756,000).

In addition, the SCA regulates "commercial electronic messages" and "electronic messages sent in bulk" to Singapore consumers. Contravention of the SCA provisions may lead to civil action by any person who has suffered loss or damage as a direct or indirect result of such a contravention.

The types of relief available are injunction, damages and statutory damages not exceeding S$25 (approximately US$19) for each electronic message, and not exceeding S$1 million (approximately US$756,000) in the aggregate, unless the plaintiff proves that his or her actual loss from such electronic messages exceeds S$1 million (approximately US$756,000).

The Singapore PDPA has come into effect in phases. The provisions relating to the DNC Registry came into effect on 2 January 2014, and the provisions relating to general data protection came into force on 2 July 2014.

PDPC is empowered to conduct investigations, upon receiving a complaint or on its own accord, to determine whether an organization is complying with the PDPA. In addition, a person who suffers loss or damage as a direct result of a contravention of the PDPA obligations by an organization has a right of action for relief in civil proceedings in a court.

The court may grant to the plaintiff in an action all or any of the following:

i. relief by way of injunction or declaration;
ii. damages; or
iii. such other relief as the court thinks fit.

[21] Articles 32 and 33 of the Act.

As to recent enforcement orders, in October 2014, a property agent was fined S$27,000 (approximately US$20,400) for sending unsolicited SMSs to advertise property developments, two in Singapore and one in London, via nine telephone numbers, using a bulk SMS-broadcasting software.

The PDPA bans firms from sending marketing messages to any number listed on the DNC Registry without first getting the owner's consent. Earlier in 2014, a tuition agency and its director were fined S$39,000 (approximately US$29,480) for violation of the DNC provisions.

There are also a few complaints currently pending review. For example, an entertainment operator has come under investigation for violation of the "protection obligation" under the PDPA. Personal details of more than 317,000 of its members were stolen and disseminated to the public. Similarly, a local telecommunications company came under scrutiny for data breaches in 12 cases of unauthorized access to customers' personal information. At the time of writing, PDPC is also looking into an alleged breach of the PDPA by a Chinese smartphone maker.

Taiwan

The Personal Data Protection Act of Taiwan (PDPA) may impose criminal sanctions for non-compliance. These include imprisonment for up to five years, detention and/or a fine of up to NT$1,000,000 (approximately US$33,700). There are also civil sanctions, such as damage compensation, of NT$500 to NT$20,000 (approximately US$17 to US$674) per person per incident; and administrative sanctions, such as a fine of NT$50,000 (approximately US$1,685) to NT$500,000 (approximately US$16,850), which may be imposed repeatedly until the violation ceases.

In addition, punishments under the Criminal Code of Taiwan and/or civil damages under the Civil Code of Taiwan, in relation to protection of privacy and confidential information, may apply.

The competent authority has the discretion to publicize the name of the entity that violates the PDPA, as well as the name of its responsible person and details of the violation. The potential damage to reputation and the customer relationship may be severe.

As the PDPA is relatively new (in effect since 1 October 2012), there have not been many cases of enforcement in Taiwan; however, more enforcement cases are expected in the future.

The PDPA does not create a data protection authority in Taiwan. Instead, it delegates the enforcement powers over private sectors to various competent authorities for the specific industries under their watch, while keeping the power of making interpretative rulings, proposing amendments, etc., with the Ministry of Justice, the agency that drafted this law and its enforcement rules in the first place.

The fashion and luxury industry is overseen by the Ministry of Economic Affairs. This authority has the power to, among others, conduct compliance audits and inspections, restrict international transmission of personal data, and impose administrative fines for non-compliance. Currently, most of the competent authorities are not very active in enforcement actions.

Where the violation is suspected to constitute a criminal offense, the prosecutor and the police will conduct investigations, which are separate from the administrative enforcement actions taken by other authorities.

Damage compensation and other civil actions are initiated by the data subjects themselves. A class action may be brought by a foundation or charity association that meets certain requirements under the PDPA.

II. Regulatory Framework for Digital and Online Services: Europe and Russia, North America, Latin America, the Asia Pacific

The first step in understanding privacy rules and, thus, the limitations and rules to be taken into account in launching digital and online strategies, is to become familiar with the main data protection principles and concepts. Hence, the purpose of this section is to report on the key principles and pillars of data protection, and other applicable pieces of legislation, that impact on fashion and luxury brands that are dealing with the digital and online ecosystem.

A. Main Concepts and Principles

1. Europe and Russia

France

Key Definitions

Personal data: any information identifying, whether directly or indirectly, a natural person (i.e., the data subject) such as an identification number, or one or more factors specific to his or her physical, physiological, mental, economic, cultural or social identity (e.g., name, address, photo, voice).

Processing of personal data: any operation or set of operations that is performed on personal data, whether or not by automatic means, such as collection, recording, organization, storage, adaptation or alteration, retrieval, consultation, use, disclosure by transmission, dissemination, or otherwise making available, alignment or combination, blocking, erasure or destruction.

Data collection: there is no legal definition of "data collection". From a practical standpoint, data is collected when this data is integrated in an electronic database or in hard-copy files (generally for further processing).

Data controller: the natural or legal person that alone or jointly with others determines the purposes and means of the processing of personal data. The data controller is therefore the person responsible for managing the data processing and complying with the applicable law, and will bear alone the burden of proving that the obligations under the applicable law have been duly fulfilled. Determining who is the data controller is fundamental, especially in the case of a worldwide processing of personal data, since the country of establishment of the data controller will allow determination of whether the FDPA is applicable.

Data storage term: this refers to the time period during which data is used and/or archived by the data controller.

Security conditions: this refers to the design and implementation of any organizational or technical measure that is implemented to protect data against accidental or unlawful destruction, or accidental loss, alteration, unauthorized disclosure or access.

Legal Grounds to Implement a Data Processing

Processing of personal data is subject to the prior consent of the data subject,[22] except where processing is necessary:

i. for compliance with a legal obligation to which the controller is subject;
ii. for the purpose of legitimate interests pursued by the data controller, provided that such interests are not overridden by the legitimate interests of the data subjects; or
iii. for performance of a contract between the data controller and the data subject.

As an example, most of the usual processing implemented by a company (e.g., payroll, human resources, management, customers, suppliers) is considered necessary for the legitimate purposes of the company and, thus, is not subject to an express consent, provided that said processing activities do not infringe the data subjects' fundamental rights and freedom.

It should be noted that processing of any sensitive data (i.e., data revealing, directly or indirectly, racial or ethnic origins, political opinions, religious or philosophical beliefs, trade-union membership, and information concerning health or sexual life) is always subject to prior consent[23] and should also be justified by a legitimate purpose. Processing of such data is strictly regulated.

Collecting and processing of sensitive data without the data subject's express prior consent is punishable by up to five years' imprisonment, and a fine of up to €300,000 for an individual/up to €1,500,000 for a company.

Information Given to the Data Subject

The data controller must inform all individuals whose personal data will be processed of the conditions of such processing.[24] Such information will have to be provided before or at the time of collection of the data, and must include the following items:

- the identity of the controller and of his or her representative, if any;
- the purposes of the processing for which the data is intended;
- whether providing answers is mandatory or optional, and the consequences, if any, of failure to reply;
- the recipients or categories of recipients of the data;
- the data subjects' right of access to, and rectification of, the data concerning them, and the practical manner of exercising such rights, including the designation of the person or service in charge of the right of access and rectification; and
- the transfer of data to a non-EU country, if any.

Information regarding the controller's identity, the purposes of the processing, whether providing answers is mandatory, the data subjects' rights of access and rectification, and the transfer of data to a non-EU country, must be provided on any form that is used to collect the data: e.g. recruitment or order forms.

Information must be provided in the French language via media evidencing that this obligation has been fulfilled: e.g., information notice, privacy policy.

[22] Article 7 of the FDPA.
[23] Article 8-I of the FDPA.
[24] Article 32 of the FDPA.

Other Applicable Principles

French data controllers must collect and process data in compliance with the following principles:

i. The data collected must be relevant to the purpose stated in the notification.

As an example, details of an employee's job title and salary are relevant for the payment of the employee, whereas data on the employee's hobbies or illnesses may be considered irrelevant.

ii. The use of social security numbers is restricted to the payment by employers of applicable fees to social security, health and retirement organizations. The transfer of a social security number is usually prohibited.

In the case of a breach, a sanction may be issued, of up to five years imprisonment, and a fine of up to €300,000 for an individual, and €1,500,000 for a company.

iii. Data must not be stored for an indefinite period of time. The storage term for the data shall be limited to the time necessary for the processing.

As an example, the general standard storage term for employees' data is the duration of the employment contract plus five years; for archival purposes, it is 20 years.

In the case of a breach, a sanction may be issued, consisting of up to three years imprisonment, and a fine of up to €45,000 for an individual, and €225,000 for a company.

iv. Security measures must be implemented. The controller must guarantee to the data subjects, on its behalf and on behalf of the processor (if any), that all the appropriate technical and organizational measures have been taken to protect personal data against accidental or unlawful destruction, or accidental loss, alteration, unauthorized disclosure or access. Please note that the data controller remains liable to the data subjects in the event of a failure in the security measures being taken.

As an example, security measures may include, without limitation: access to the premises where the database or computers are located, subject to a badge; access to the database, subject to an ID and password; and access to the network, protected by a firewall.

Failure to enforce the applicable security measures is punishable by up to five years imprisonment, and a fine of up to €300,000 for an individual, and €1,500,000 for a company.

Transfer of Data to a Non-protective Country

In accordance with article 68 *et seq.* of the FDPA, transfers of personal data:

- outside the Economic European Area (EU countries, plus Iceland, Liechtenstein, Norway), unless the data is transferred to countries considered to have "adequate" data protection laws;[25]
- through the conclusion of a data transfer agreement based on the EC's model clauses; or
- to a company that has appropriate safe harbor certifications for transfers made to the United States of America[26]

[25] Countries that have been recognized as providing a sufficient level of protection by the EC include Andorra, Switzerland, Canada, Argentina, Jersey, Guernsey, Israel, Feroe Islands, Uruguay and the Isle of Man.

[26] Other means to secure such transfers (including individuals' consent) do exist under the FDPA but are usually considered unreliable by CNIL, unless in certain limited circumstances, which are not met in the present instance (e.g., "one-shot" – non-structural – transfers of personal data).

will have to be declared to CNIL, together with the main relevant processing operations, by filing a specific appendix describing the relevant transfer, which will be specifically approved by CNIL.

Notification to CNIL

Pursuant to the FDPA, the data controller must notify CNIL of any personal data processing, prior to its implementation, when the FDPA is applicable.

CNIL requires that one notification be filed per purpose of data processing, unless otherwise agreed by CNIL, which allows a unique notification when purposes are connected.

For example, the notifications to be filed with CNIL usually include HR data processing for HR management (including payroll and recruitment and talent management), use of badges, video surveillance; clients' data processing for clients' relationship management (including marketing, processing of orders and invoicing); and suppliers' data processing for the management of relationships with suppliers.

However, certain categories of data processing may be exempted from the prior notification process, provided they comply with one of CNIL's exemption decisions.[27]

As an example, processing of suppliers' data can be exempted from notification, provided such processing complies with all the conditions set forth in exemption n. 4; payroll processing can be exempted from notification, provided it complies with all the conditions of exemption n. 2.

There are three main categories of notification form:

i. normal notification form (*déclaration ordinaire*);
ii. simplified notification form (*déclaration simplifiée*); and
iii. request for authorization (*demande d'autorisation*).

The normal notification form is to be used where the data processing is usual, and does not raise specific privacy and public freedom concerns (such as processing of sensitive data or processing for specific purposes[28]) that would need to be authorized by CNIL.

A simplified notification form may be used when the data processing complies with the conditions of one of the CNIL's simplified standards, in which case the data controller must fill in a simplified notification form.[29]

Absence of notification when required, or a simplified notification of a data processing that does not comply with the standard defined by CNIL, is sanctioned by up to five years imprisonment, and a fine of up to €300,000 for an individual, and €1,500,000 for a company.

Diversion of the purpose of the data processing as notified is punishable by the same sanctions.

[27] The list of CNIL's exemptions is available on CNIL's website at: http://www.cnil.fr/documentation/deliberations/dispenses-de-declaration.

[28] Such specific purposes include automatic processing, which may, due to its nature, importance or purposes, exclude persons from the benefit of a right, a service or a contract, or combining of files with different main purposes.

[29] A list of simplified standards is available on CNIL's website at: http://www.cnil.fr/documentation/deliberations/normes-simplifiees/.

Criteria for Application

The FDPA applies to any personal data processing that meets one of the following criteria:[30]

i. the processing is carried out by a data controller in the context of the activities of an establishment situated in France; or
ii. if the data processing is carried out by a data controller established outside of the EU but that uses equipment or processing means located in France for the purpose of data processing, and not for the purposes of transit through this territory or that of any other Member State of the EU.

Regulatory Requirements Applicable to the Digital Dimension

Consent of the Data Subject

Processing of personal data is subject to the prior consent of the data subject,[31] except where the data processing is necessary:

i. for compliance with a legal obligation to which the controller is subject;
ii. for the purpose of legitimate interests pursued by the data controller, provided that such interests are not overridden by the legitimate interests of the data subjects; or
iii. for performance of a contract between the data controller and the data subject.

Information Given to the Data Subject

Please see the above section on "Legal Grounds to Implement a Data Processing".

Spam

The principle governing the sending of marketing communications to consumers in France is that of the "opt-in" procedure. Therefore, according to the CPEC, the data controller and/or its partners shall individually collect consumers' consent prior to the sending of any marketing communications.[32]

There is an exception to the "opt-in" rule, which applies if the following conditions are met:

- a person's details are obtained in the course of a sale, or negotiations for a sale of a product or service;
- the messages are only marketing similar products or services; and
- the person is given the opportunity to refuse marketing when the relevant details are collected, and if the person does not opt out at this point and is given a straightforward way to refuse future messages.

Cookies

Regarding advertisement/commercial cookies, the data controller must obtain the user's consent before implementing them.[33] The only exceptions to this rule apply to cookies that either:

i. only enable or facilitate electronic communication; or

[30] Article 5 of the FDPA.
[31] Article 7 of the FDPA.
[32] Article 34-5 of the CPEC.
[33] Article 32II of the FDPA.

ii. are strictly necessary for the provision of the service – e.g., prior consent is not required for session cookies.

Indirect Collection of Personal Data

The FDPA makes a distinction between direct and indirect collection of personal data.

An indirect collection of personal data occurs when the data is not collected directly from the data subject.[34] In this case, indirect collection of personal data is permitted if the data controller provides the data subject with the mandatory set of information listed above[35] at the time of recording personal data or, if disclosure to a third party is planned, no later than the time when data is first disclosed.

These legal provisions are intended to ensure that personal data is collected fairly, which means that the data subject is aware of the data collection, according to the transparency principle. Any kind of data collection that takes place without the data subject's knowledge is deemed unfair and is therefore forbidden.

Sanctions

For a detailed description of applicable sanctions, please see section C above.

Germany

Main Definitions

Personal data means any information relating to the personal or material circumstances of an identified or identifiable individual (*data subject*).

Special categories of personal data means information on racial or ethnic origin, political opinions, religious or philosophical beliefs, union membership, or health or sex life.

Automated processing means the collection, processing or use of personal data by means of data processing systems, where

- *collection* is the acquisition of personal data;
- *processing* is the storage, modification, transfer, blocking and erasure of personal data; and
- *use* is any utilization of personal data other than processing.

Controller means any person or body collecting, processing or using personal data on his, her or its own behalf, or commissioning others to do so.

Transfer means the disclosure to a third party of personal data stored or obtained by means of data processing, either through transmission of the data to the third party or through the third party inspecting or retrieving data held ready for inspection or retrieval.

Main Privacy Requirements

In general, the FDPA and, therefore, the following privacy requirements only apply to data controllers, not to data processors. Data processors process personal data on behalf of the data controller, have to comply with the instructions given by the data controller, and have to safeguard the protection of personal data by organizational and technical measures, whereas the data

[34] Article 32 III of the FDPA.
[35] Art. 32 FDPA.

controller remains responsible for the processing of data complying with all the provisions of the FDPA. There must be a written contract between the data controller and data processor that addresses certain issues in the FDPA. If the data processor is located outside the European Economic Area (EEA) or the EU, it must be guaranteed an adequate level of data protection.

Under the FDPA, the processing of personal data requires a statutory permission or consent from the data subject. The FDPA itself contains important statutory permissions for the processing of personal data: e.g., the processing is permitted if it is necessary to perform the obligations of the data controller under a contract with the data subject. Very specific statutory permissions exist for the collection and processing of personal data for the purposes of marketing and opinion research.

As described below, consent is not mandatory but a valid consent may create legal grounds for the processing of personal data. In order to be valid, consent must be given voluntarily, on an informed basis, explicitly and unambiguously. Voluntary consent means that the data subject must not be under any undue influence when giving consent. For example, some DPAs have contested the voluntariness of consent given by employees to their employer, since employees could feel forced to give their consent in order to avoid problems at the workplace. Furthermore, the data subject must have been provided with a clear picture of the personal data and the purposes for which such data is collected and processed; in particular, the data subject must be informed about the recipients of the information, in order to be aware of the possible consequences of the relevant consent. Thus, consent obtained from children is likely to be invalid, even though the ability to give valid consent does not depend on reaching the legal age.

Consent must be given in a clear and unambiguous manner. Generally speaking, with websites, consent cannot be obtained by pre-ticked checkboxes, since it remains uncertain whether the data subject has seen the checkbox or just clicked on the submit button without reviewing the displayed information.

In general, the data subject must be provided with clear information about the processing of relevant personal data. The information notice must describe the kind, extent and purpose of collection and use of personal data, and should also give information about the processing of personal data outside the EU/EEA, as applicable. Depending on the context in which personal data is collected or processed, other notification requirements may apply.

Generally, personal data may only be processed for the purposes for which it was collected – the so-called principle of appropriation. Changing the purpose of the processing requires consent or a statutory permission.

Transfer of personal data to other data controllers in itself qualifies as data processing. Therefore, a statutory permission or consent is required. There are few statutory permissions: e.g., limited categories of personal data may be transferred without express consent, for the purposes of market and opinion researches, or for the purposes of credit default protection.

International transfers of personal data to data controllers outside the EU/EEA require a guarantee that the recipient is bound to an adequate level of data protection. The appropriate means of ensuring an adequate level of data protection are determined on the basis of the relevant EC decisions. Currently, an adequate level of protection can be recognized on the basis of:

- a EU Commission decision on the adequacy of the data protection laws of certain countries (e.g., Switzerland);
- adhesion to the safe harbor, in the case of a U.S. data recipient;

- adoption of so-called binding corporate rules; and
- adoption of the EU model clauses.

Data controllers and data processors have to protect the security and confidentiality of personal data through technical and organizational measures. The FDPA contains a list of objectives that must be accomplished by such measures: e.g., they shall prevent unauthorized persons from gaining access to data processing systems. Such measures typically include user authentication and authorization, physical protection, encryption, etc.

The law is quite unspecific regarding the requirements that have to be fulfilled, so that the requirements can be adopted to new technologies without legislative action. In practice, enforcement actions taken by the DPAs and industry standards should be considered when determining the necessary technical and organizational measures.

Criteria for Application

The FDPA applies if personal data is collected, processed or used in Germany and:

i. the data controller is established in Germany;
ii. the data controller is not established in Germany but within the EEA, and a German branch of the data controller collects, processes or uses the personal data; or
iii. the data controller is established outside the EEA and the personal data is not only transferred through Germany.

The operation of a website that asks its users to enter personal data may be subject to the provisions of the FDPA even if the servers are located outside the EEA, if the user's device is located within the EEA.

In this regard, some commentators argue that the operator of the website uses the user's device to collect personal data (i.e., the data is collected in Germany on the user's device and not abroad on the web server); it follows the FDPA would apply. Other commentators argue that the device is controlled by the user and cannot be regarded as the long arm of the website operator. In any case, the collection of personal data through a website that is directed at a German audience should be reviewed carefully, to mitigate any compliance risks.

Moreover, the FDPA may be applied through a back door: when a business targets a German audience, the consumer protection provisions of the German Civil Code are most likely applicable to website terms of use, privacy policies, standard terms of use and other agreements with consumers. Under the German law on standard business terms, provisions in standard business terms are void, and statutory law applies, if they constitute an unreasonable disadvantage to the consumer.

Some appeal courts have decided that provisions regarding data protection in website terms of use or privacy policies are standard business terms, and that they constitute an unreasonable disadvantage to consumers if they deviate substantially from the FDPA. Therefore, such clauses have been held unenforceable under German law on standard business terms, and statutory law (i.e., the FDPA) has been applied instead. This leads to an indirect application of the FDPA when doing business with consumers located in Germany, regardless of the applicability of the FDPA itself. This is a rather new development and all consequences are still to be assessed.

It seems that German DPAs would have no jurisdiction in such cases but consumer protection agencies may be able to bring cease-and-desist claims against the website operator.

Regulatory Requirements Applicable to the Digital Dimension

Digital CRM structures represent complex systems that collect and process personal data in several different ways for multiple purposes. It is therefore likely that nearly all data protection requirements would be applicable and CRM structures should, hence, also be designed on the basis of data protection laws.

Data controllers should provide clear information to the data subjects: i.e., by providing a privacy policy on the website. This requires a clear picture of the categories of personal data that are collected and processed, and therefore requires good documentation of the processes and data flow within the CRM.

A controller must ensure that personal data is only processed and/or stored as long as is permissible. For example, personal data should be deleted when it is no longer necessary for the purpose of performing contractual obligations, unless the data subject has given its consent. CRM must hence be designed so to allow the evaluation of the purposes for which a specific set of personal data may be used and of the time when such permissible use no longer applies.

When obtaining consent, the requirements described above apply; thus, it is important to design the user interface carefully: e.g., attention should be devoted to the use of pre-ticked checkboxes. Consent must be recorded and the data subject must have access to the exact wording of the consent given; this is particularly important when personal data is used for marketing purposes.

CRM must be equipped with technical measures, and must allow for organizational measures to protect personal data at a state-of-the-art level, which includes encryption, access control and regular backup.

Sanctions

In the case of non-compliance with the FDPA, German DPAs may issue fines of up to €300,000, and a fine may even be higher, if necessary, to skim the financial benefit derived from an infringement. Fines are not very common, though. DPAs usually give orders to ensure future compliance with the FDPA, which may include shutting down data-processing operations until they become compliant.

In addition, certain individuals and private bodies may bring claims against parties that (allegedly) infringed data protection laws. In particular, preliminary injunctions may be sought and obtained rather easily, but it could be hard to adhere to them if the CRM does not provide for means to block personal data and stop processing of certain data sets until the preliminary injunction is successfully contested.

For a detailed description of the applicable sanctions, please see section C above.

Italy

The Privacy Code provides for the following main definitions:

- *processing* means any operation, or set of operations, carried out with or without the help of electronic or automated means, concerning the collection, recording, organization, keeping, interrogation, elaboration, modification, selection, retrieval, comparison, utilization, interconnection, blocking, communication, dissemination, erasure and destruction of data, whether the latter is contained in a data bank or not;

- *personal data* means any information relating to natural persons that are or can be identified, even indirectly, by reference to any other information, including a personal identification number;
- *sensitive data* means personal data allowing the disclosure of racial or ethnic origin, religious, philosophical or other beliefs, political opinions, membership of parties, trade unions, associations or organizations of a religious, philosophical, political or trade-unionist character, as well as personal data disclosing health and sex life details;
- *data controller* means any natural or legal person, public administration, body, association or other entity that is competent, also jointly with another data controller, to determine purposes and methods of the processing of personal data and the relevant means, including security matters;
- *data processor* means any natural or legal person, public administration, body, association or other agency that processes personal data on the controller's behalf;
- *persons in charge of the processing* means the natural persons that have been authorized by the data controller or the data processor to carry out processing operations;
- *data subject* means any natural person that is the subject of the personal data;
- *communication* means disclosing personal data to one or more identified entities other than the data subject, the data controller's representative in the state's territory, the data processor and persons in charge of the processing in any form whatsoever, including by making available or interrogating such data;
- *dissemination* means disclosing personal data to unidentified entities, in any form whatsoever, including by making available or interrogating such data;
- *anonymous data* means any data that, either in origin or on account of its having been processed, cannot be associated with any identified or identifiable data subject;
- *blocking* means keeping personal data by temporarily suspending any other processing operation; and
- *data bank* means any organized set of personal data, divided into one or more units located in one or more places.

Key Privacy Requirements

<u>Notification</u>

The obligation to file a notification with the Garante is triggered by performance of specific data protection activities and data types, which may be summarized as follows:

i. genetic and biometric data –data disclosing geographic locations of individuals or objects;
ii. data disclosing health and sex life details being processed for specifically identified purposes;
iii. data disclosing sex life details and the psychological sphere being processed by non-profit organizations;
iv. profiling of data subjects and/or their personalities, analyzing consumption patterns and/or choices, and monitoring the use of electronic communications services;
v. sensitive data for personnel selection purposes on behalf of third parties, as well as sensitive data used for opinion polls, market surveys and other sample-based surveys; and

vi. data stored in ad-hoc data banks, managed by electronic means, in connection with creditworthiness, unlawful and/or fraudulent conduct.

Information Given to the Data Subject

The data subject, notably the individual whose data is processed, has to be provided with a set of information, which includes the following items:

i. the purposes and conditions of the processing, in detail;
ii. whether providing personal information is necessary or mandatory;
iii. the consequences if the data subject does not provide data;
iv. the extent of data communication (meaning listing at least the categories of data recipients) and whether data is meant to be disseminated;
v. the privacy rights of the data subject; and
vi. the identification details of the data controller, the data processor and the privacy representative of the controller, as applicable.

The Privacy Code sets out specific rules and exemptions in relation to the moment when the information has to be provided, and in relation to cases when the information may not be provided; these issues are to be considered on a case-by-case basis.

Consent

Consent to the processing, in general, is necessary, although exemptions apply. For example, for compliance with contractual and legal obligations, meaning that when a controller processes personal (not sensitive) data in order to comply with obligations stemming from a contract to which the data controller and the data subject are parties, or to comply with obligations deriving from applicable laws, the consent of the data subject is not necessary.

Again, consent must be:

- express: the Privacy Code does not provide for implied consent;
- free: the result of the free will of the data subject;
- specific: it is necessary to collect one consent for each processing purpose that is sought;
- informed: obtained on the basis of the set of information that has to be provided to the data subject;
- prior: obtained before the data processing starts; and
- in writing: for personal and sensitive data.

Other Requirements

In general terms, a data controller may only collect and process the number and kind of personal information that is necessary to achieve a predefined and legitimate purpose. According to the same rationale, data may be stored only for the time necessary to achieve the processing purpose sought, and cannot be stored for an undefined period of time.

Personal data should be either deleted or rendered anonymous whenever the legitimate time for data retention lapses: notably, once the processing purposes have been fulfilled and relevant legal obligations have been met.

The Privacy Code does not currently provide for the role of a data protection officer. A similar role is performed by the internal data processor (*Responsabile interno del trattamento*).

In the case of outsourcing, it is necessary to appoint an external data processor (*Responsabile esterno del trattamento*), providing it with detailed instructions, and also providing adequate means for the data controller to verify the activity of the data processor, in order to ensure compliance with the Privacy Code and the instructions of the data controller.

The data controller has an obligation to properly select a data processor that provides adequate guarantees of compliance with the Privacy Code and, at the same time, has an obligation to verify the processing activities performed by the data processor and relevant conditions, including data security matters.

Importantly, the Privacy Code provides for specific physical, technical and organizational security measures that a data controller has to adopt in order to protect data against the risks of:

- destruction and loss, whether by accident or not;
- unauthorized or unlawful access;
- unlawful processing activities; and
- processing activities that are inconsistent with the purposes for which data was originally collected and processed.

The security measures have to be evaluated taking into consideration such criteria as what is currently technically state-of-the-art, the nature and kind of the data that is processed, and the specific features of the data processing being carried out.

The Garante has provided for specific security measures to be applied in certain cases. It follows that data controllers have to perform a factual evaluation of the conditions and features of their data processing, in order to identify the required security level and applicable security precautions.

It should be noted that, among other requirements to take into account, the Garante has issued specific guidelines applicable to system administrators.[36]

Privacy Rights

The Privacy Code gives[37] a number of rights to the data subjects. These rights should be carefully considered by the data controller, since it has an obligation to put individuals in a position to enforce their privacy rights easily and within fixed timeframes.

The main privacy rights available to an individual may be summarized as follows. To:

- be informed whether a data controller holds, or not, personal data about the individual;
- be informed of how personal data is being processed;
- access personal data;
- request that personal data be corrected, amended, updated, or made anonymous;
- ask for data deletion;
- ask for information on the source of data;
- request a blocking of data that has been processed unlawfully; and
- object to the data processing on legitimate grounds.

[36] The Guidelines of the Garante on system administrators are available in English at http://www.garanteprivacy.it/web/guest/home/docweb/-/docweb-display/docweb/1628774.
[37] Article 7 of the Privacy Code.

International Data Transfers

Generally speaking, transfer of data to a data controller established within the EU is allowed and is ruled a communication of data among data controllers; hence, the relevant rules apply.

The Privacy Code, in principle, prohibits the transfer of personal data outside the EU to third countries, notably countries that have not been recognized by the European Commission (a decision that has to be ratified by the Garante in order to be enforceable in Italy) as providing an adequate level of data protection. However, the transfer to third countries is allowed when one of the following requirements is fulfilled:

i. the data subject provided consent (specific conditions apply);
ii. the data transfer is necessary in relation to performance of contractual obligations (specific conditions apply);
iii. the transfer is necessary for the public interest (specific conditions apply);
iv. the transfer is necessary to safeguard a third party's life or bodily integrity (specific conditions apply);
v. the transfer is necessary for defense investigations, or to establish or defend a legal claim (specific conditions apply);
vi. the transfer is carried out in response to a request for access to administrative records, or for information contained in publicly available registers, lists, records or documents, in compliance with the specific provisions applying to this subject matter;
vii. the transfer is necessary for scientific, statistical or historical purposes (specific conditions apply);
viii. the transfer is authorized by the Garante; or
ix. the transfer is authorized by the Garante following a decision of the European Commission (specific conditions apply).

Criteria for application

The Privacy Code generally applies to data controllers that are established in Italy, as well as data controllers that are established outside the EU but, for the data processing, make use of "equipment" that is based in Italy – except for equipment that is used for the purpose of *mere conduit* within the EU.

In the latter case, the non-EU-based data controllers have to appoint, for privacy purposes, a representative that is established in Italy, which, among other things, is expected to take care of dealing with requests from data subjects, and to liaise with data subjects about matters relating to the processing of their personal data and to the application of privacy law provisions.

Regulatory Requirements Applicable to the Digital Dimension

The above-listed requirements all apply, in general terms, to the processing of personal data in the digital and online environment. Special attention should be paid to the following requirements:

i. information to customers and consent of customers;
ii. notification of performance of profiling activities;
iii. sharing of customer data with third parties, which also includes the sharing of customer data with other companies of the same group;
iv. trans-border data flows;

v. data security measures;
vi. procedures in place to guarantee correct and timely enforcement of privacy rights of customers; and
vii. the privacy role and obligations of third parties acting as data processors.

Also important is the issue of data retention, in the sense of the length of time a data controller may keep personal information relating to shopping habits, preferences and purchasing histories of customers.

Under the guidelines issued by the Garante in 2005,[38] and as a consequence of a number of further provisions issued in the course of prior checking procedures started by different data controllers, the general rule is that personal information relating to the profiles of customers may be kept for only one year when used for profiling purposes, and this information should thereafter be either deleted or made anonymous.

Data controllers wishing to keep and use profiling data for a longer period of time have to file a prior checking procedure with the Garante.

In brief, a prior checking procedure under the Privacy Code[39] has to be initiated in the case of data processing activities that present specific risks. Risks are to be assessed on the basis of the following criteria: the kind and nature of the data processed; the conditions of the data processing; and the possible consequences of the data processing, especially in relation to the data subjects' personal sphere.

In such cases, the data controller must ask the Garante to verify the processing activities intended to be carried out. The Garante assesses the data processing, and may decide that it is or is not in line with the Privacy Code. In any case, the Garante can specify measures and arrangements that the data controller has to adopt.

The need for a prior checking procedure stems from the fact that profiling activities are considered a risky activity from a privacy perspective.

Indeed, profiling means gathering personal information in order to build a specific profile of an individual, thus encroaching on his or her private life. It follows that performance of profiling activities triggers, on the one hand, the obligation to file a notification with the Garante, and, on the other hand, requires that specific safeguards be put in place.

Keeping profiling information for more than one year therefore represents a risk from a privacy perspective, and if a data controller wishes to do this, it has to ask the Garante to carry out prior checking.

Spam

Regarding marketing activities via email, the Privacy Code requires prior and express consent of the individual. This provision is usually referred to as the "opt-in" approach.

An exception to the opt-in approach applies when a data controller wishes to use, for marketing purposes, the email address of a data subject when said email address has been collected in relation to the sale of the data controller's products or services. In this case, the data subject's consent is not necessary, provided that all of the following conditions are met:

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[38] The guidelines are available in English on the Garante website at http://www.garanteprivacy.it/web/guest/home/docweb/-/docweb-display/docweb/1109624.
[39] Article 17 of the Privacy Code.

i. the products or services that are the subject matter of the marketing communications are the same or similar to these that have been previously purchased by the data subject;
ii. the data subject has been adequately informed about the marketing activities; and
iii. the data subject has not objected to the receiving of marketing communications, either initially or thereafter.

In addition, the data subject must be informed that it can object to receiving the marketing communications at any time, through simple means and at no charge. This information has to be provided to the data subject when data is first collected, and thereafter must be contained in each marketing communication that is sent.

In general terms,[40] when marketing communications are multichannel (e.g., communications that may be sent through different means, such as email, newsletter or SMS, as well as more traditional tools, like paper mail), the individual should be informed, and also given the opportunity not only to choose the preferred means of communication but to opt out at any moment and in an easy way from one or all of the communication tools that are used.

Cookies

The Garante has issued a document containing FAQs on cookies[41] and also specific guidelines for the use of cookies.[42]

In brief, the Garante has adopted a double-tier approach, in the sense that the issue of cookies should be dealt with through a short and a longer privacy notice.

The short privacy notice should consist of a banner displayed when a user first visits any page of a website. The consent of the user to cookies (when necessary) should be asked for in the first instance, through this short banner.

The short banner should be coupled with a longer and more exhaustive privacy notice (usually referred to as a cookies policy). The cookies policy should be available from any page of the website and give the user the opportunity to make granular choices: i.e., choose whether to accept or refuse all cookies or only some of the cookies on a website.

Furthermore, it should be always possible for a user to check the choices made in relation to cookies and to change them easily.

It should be noted that these rules apply not only to "traditional" cookies but to any tracking technologies that may be deployed on internet websites, as well as mobile sites and relevant features.

The overall approach is that consent is necessary for cookies other than technical and functional cookies. In other words, consent is not required for cookies that are necessary to make a website run properly or for cookies that are functional in the performance of services or actions that are required by the user.

User consent is required for cookies that are deployed for marketing, advertising or profiling purposes.

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[40] Specific conditions and rules apply.
[41] The FAQs on cookies are available in English at http://www.garanteprivacy.it/web/guest/home/docweb/-/docweb-display/docweb/2146935.
[42] The guidelines on cookies are available in English at http://www.garanteprivacy.it/web/guest/home/docweb/-/docweb-display/docweb/3167654.

Analytics cookies usually require user consent, unless they make use of non-identifiable information and are first-party cookies: i.e., cookies managed by the website owner. For analytics cookies, specific conditions apply, to be considered on a case-by-case basis.

Sanctions

Fashion and luxury brands are on the radar of the Garante, and several audits and investigations have been performed recently. In addition to general compliance with the Privacy Code, there is a specific focus on CRM activities, especially in relation to information and consent requirements, data retention periods, trans-border data flows, and the sharing of customer data with third parties.

Regarding cookies, in the relevant guidelines, issued on 8 May 2014, the Garante expressed the view that implementation of the applicable provisions would have a material impact, not just from an economic perspective, on stakeholders, and therefore compliance with the guidelines would require significant effort and time. Accordingly, the Garante has provided a transition period before the enactment of the guidelines – they will come into force on 3 June 2015.[43]

For a detailed description of the applicable sanctions, please see section C above.

Poland

The most important definitions provided by the Personal Data Protection Act of 1997 (DPA) are the following:

- *Personal Data*: any information concerning an identified or identifiable natural person.
- *Identifiable Natural Person*: a person whose identity can be established, directly or indirectly, in particular by reference to a certain identification number, or one or more distinctive factors describing a person's characteristics, whether physical, physiological, mental, economic, cultural or social.
- *Data Filing System*: any structured set of data of a personal nature accessible according to particular criteria, be it dispersed or rendered in a by-function arrangement.
- *Data Controller*: the person or entity who, or which, decides on the purposes and means of processing personal data. This may include state authorities, legal persons and organizational units having no legal personality.
- *Processing of Data*: any personal data operations, such as collection, recording, storage, developing, changing, sharing and removing, and particularly those performed in computer systems.
- *Consent of the Data Subject*: a declaration of will that includes consent to the processing of personal data. The consent cannot be presumed or implied from a declaration of will with different contents. The consent can be revoked at any time.
- *Data Recipient*: anyone to whom the personal data is disclosed; excluding, however, the data subject, persons authorized to process data, the data processor, state authorities or territorial self-government authorities to whom the data is disclosed in connection with pending proceedings, or a representative of the data controller established or domiciled in a third country.
- *Third Country*: any country not belonging to the EEA.

[43] The guidelines on cookies have been published in the Official Gazette n. 126 of 3 June 2014.

The DPL imposes four types (pillars) of obligations on data controllers:

i. to process personal data on legal grounds;
ii. to provide certain information about processing to a person whom the data concerns (i.e., data subject);
iii. to submit a data filing system to the DPA for registration (some exceptions apply); and
iv. to properly secure a data filing system.

International data transfers may not take place unless the destination country ensures at least the same level of personal data protection as that in force in Poland. It should be noted that the DPA does not recognize U.S. law generally as providing a level of protection equivalent to that of Poland. However, if a data importer in the U.S. is a safe harbor registered company, the DPA takes the view that the requirement of providing an equivalent level of protection is met. There are certain exceptions to the general rule against transfer of personal data to territories with inadequate data protection laws, the most relevant being where:

- the transfer is required by other laws, or by the provisions of any ratified international agreement, which guarantee an adequate level of personal data protection;
- the data subject has given written consent;
- the transfer is necessary for the performance of a contract between the data subject and the data controller, or takes place in response to the data subject's request;
- the transfer is necessary for the performance of a contract concluded in the interests of the data subject between the data controller and a third party;
- the transfer relates to personal data that has been made public;
- the transfer is necessary on public interest grounds, or for the establishment, exercise, or defense of legal claims; or
- the transfer is necessary to protect the vital interests of the data subject.

If the transfer is to a country outside the EEA and none of the above grounds for transfer apply, prior consent of the DPA is required to legitimize the transfer.

Criteria for Application

The DPA applies to:

- state or territorial self-government authorities, other state or municipal organizational units, as well as non-public subjects carrying out public tasks; and
- natural and legal persons and organizational units not being legal persons, if they are involved in the processing of personal data as a part of their business or profession, if they are seated in Poland or in a third country, provided that they process personal data using technical measures situated in the territory of Poland.

The DPA does not apply to:

- natural persons who process personal data solely for personal or domestic purposes; and
- subjects having their seat or place of residence in a third country, which use technical measures situated in the territory of the Republic of Poland solely for data transfer purposes.

Regulatory Requirements Applicable to the Digital Dimension

Provision of online services is regulated by, among others, the Act on Rendering Services Through Electronic Means of 2002 (Electronic Services Law). Below are the main additional provisions to be taken into account:

- digital personal data is protected regardless of whether it is processed in a data filing system;
- the service provider may, in principle, process only certain types of personal data. Processing of further data typically requires explicit consent; and
- additional information duties apply: e.g., with respect to disclosing the identity of the data processor or describing technical security means.

Moreover, the Electronic Services Law prohibits sending unsolicited commercial information addressed to specified consumers. Finally, there are also important restrictions in the Telecommunications Act 2004 on direct marketing using automated systems and the placing of cookies on users' devices.

Sanctions

The potential sanctions for non-compliance include:

- administrative liability: i.e., the DPA may issue a decision requiring the data controller to take particular action to cease and/or remedy the breach, including an order that:
  - irregularities in data processing be removed;
  - personal data be updated, rectified, made available or unavailable;
  - additional measures securing the collected personal data be applied;
  - transfer of personal data to a third country be discontinued;
  - data be secured or transferred to other entities; and
  - personal data be deleted;
- criminal liability for corporate officers, and, in some cases, employees, of the data controller, including fines and even imprisonment for up to three years. In practice, to our knowledge, the penalty of imprisonment has not yet been imposed, but the mere risk of such a penalty should be taken seriously; and/or
- civil liability for infringement of the data subject's personal rights, including monetary compensation and an apology.

Spain

Some of the main definitions provided by Act 15/1999, 13 December, on Personal Data Protection (Spanish Data Protection Act) are as follows:

- *Personal data*: any information concerning identified or identifiable natural persons;
- *Processing of data*: operations and technical processes, whether or not by automatic means, which allow collection, recording, storage, adaptation, modification, blocking and cancellation, as well as assignments of data resulting from communications, consultations, interconnections and transfers;
- *Data controller*: natural or legal person, whether public, private, or administrative body, which determines the purpose, content and use of the processing;

- *Data processor*: the natural or legal person, public authority, service or any other body, which alone or jointly with others processes personal data on behalf of the controller;
- *Data subject*: the natural person who owns the data undergoing the processing operations;
- *Consent of the data subject*: any free, unequivocal, specific and informed indication of his or her will by which the data subject consents to the processing of personal data relating to the data subject;
- *Assignment or communication of data*: any disclosure of data to a person other than the data subject; and
- *Cancellation of personal data*: procedure through which the data controller stops using data. Cancellation implies blocking the data, which consists of its identification and reservation in order to prevent processing except to provide it to public administrations, judges and courts for the purpose of dealing with any liability arising from processing, and only for the duration of such liability. On the expiry of such a term, the data shall be deleted.

In this respect, according to SDPA's determination, the expression "blocking"[44] means that access to the personal data by the personnel that usually has access is not possible. Access shall be limited to a person with the maximum responsibility and by virtue of a judicial or administrative request.

Additionally, the main data protection requirements under the Spanish Data Protection Act and the Royal Decree 1720/2007, 21 December, which approves the regulations implementing the Spanish Data Protection Act (regulations) are as follows.

Data Quality Principle

Such a principle must be guaranteed at all times, and implies that personal data must be adequate, relevant and not excessive in relation to the scope and the specified, explicit and legitimate purposes for which it was obtained; personal data subject to processing may not be used for purposes incompatible with those for which it was collected; personal data shall be accurate, complete and updated; personal data shall be cancelled when it is no longer necessary or relevant for the purposes for which it was obtained or recorded; personal data shall be stored in a way that permits the right of access to be exercised, unless lawfully cancelled; and collection of data by fraudulent, unfair or illicit means is prohibited.

Right to Information

Data subjects must be provided with the following information prior to collection of their personal data:

i. the existence of a file or processing operation, the purpose of collecting the data and the recipients of the information;
ii. the mandatory or voluntary nature of replying to the questions raised;
iii. the consequences of obtaining the data or refusing to provide it;
iv. the possibility of exercising the rights of access, rectification, cancellation and objection; and

[44] Please see the Legal Report 0197/2013, which refers to a previous report of 2007, available in Spanish at https://www.agpd.es/portalwebAGPD/index-ides-idphp.php.

v. the identity and address of the controller, or of his or her representative, if any.

Nevertheless, items b), c) and d) shall not apply if its content can be clearly deduced from the nature of the personal data requested or the circumstances under which it was obtained.

If personal data has not been directly obtained from the data subject, the data subject must be informed by the controller, within three months from the recording of the data, of the content of the processing, the origin of the data and the information set out above in items a), d) and e).

The above provisions shall not apply in several exceptions stated in the Spanish Data Protection Act, such as where this is explicitly provided by law.

Regarding the way in which information must be provided, the regulations establish that controllers must use means that can prove the fulfillment of this right and that shall be kept throughout the duration of the processing of the data. Supports on which compliance with the duty to inform is recorded must be kept by controllers. For that purpose, the controller may use computer or telematics means. Paper documents may be scanned, as long as there is a guarantee that there has been no alteration to the original documents during the scanning process.

If questionnaires or forms are used, the relevant information must be provided in a legible way.

Consent

As a general rule, prior and unequivocal consent must be sought for the processing of personal data after having provided the information referred to above. Even if the information above must be provided, in any event, to the data subject, there are certain exceptions to the general consent rule, such as when the data refers to the parties of a contract or pre-contract in a negotiation, labor or administrative relationship, and is necessary for its maintenance or fulfillment.

In order to obtain consent for a disclosure, data subjects must be informed of the name, address, and type of activity of the recipient and the purpose of the disclosure.

Tacit consent, subject to certain rules, may be obtained except when the law provides otherwise (e.g., when sensitive data is collected).

The burden of proof that consent was obtained rests with the controller.

Notification of Data Filings

Data controllers are obliged to notify, and register their personal data filings with, SDPA's Registry. Registration must be performed prior to any data processing operation. The notification of data filings must be updated at all times. Therefore, SDPA must also be notified of any change in the filing. Notification of data filings is done via the official form available at SDPA's website, which can be sent either in paper form or electronically.

Security Requirements

The regulations establish specific and comprehensive security measures that apply to both automated and non-automated processing of personal data. Security measures are classified as basic, medium or high level. The type of data processed determines which level is applicable in each case.

Data Processors

When the data controller engages a data processor, an agreement between them must be signed, including certain specific content established by the Spanish Data Protection Act and the regulations.

International Transfers of Personal Data

As a general rule, an authorization from SDPA is needed for international transfers of personal data (transfers outside the EEA) unless any of the exceptions apply. These include:

- if the transfer is consented to by the data subject;
- if the recipient is located in the U.S. and is safe-harbor certified; and
- if the receiving controller is established in a country that offers an adequate data protection level.

In any event, even when an exception applies, a notification to SDPA, subject to its approval, is necessary (this is a simpler process than the authorization procedure). Also, consent is always necessary for controller-to-controller transfers.

Criteria for Application

Spanish data protection legislation is applicable in the following cases:

- the data processing operations are carried out in Spain as part of the activities of an establishment of the data controller. Where no data controller is established in Spain but data is processed by means of a data processor established in Spain, the processor will be bound by the technical and organizational security measures set forth in the regulations;
- the data controller is not established in Spain but is subject to Spanish law, pursuant to international public law rules; and
- the data controller is not established in the EU but uses means located in Spain to carry out data processing operations other than merely for transit purposes (e.g., where personal data is collected by a Spanish affiliate). In this case, the data controller must designate a representative established in Spain.

SDPA has determined that the use of cookies installed in the computers of Spanish users triggers application of Spanish data protection legislation.[45]

Regulatory Requirements Applicable to the Digital Dimension

Generally, and subject to additional requirements that may be relevant to the particular case, the main Spanish requirements referred to above must be fulfilled in any event for digital CRM activities. In addition to such general requirements, please note the following:

- when obtaining consent for the processing of personal data for publicity or commercial activities (e.g., sending commercial communications), data subjects must be provided with information about the specific sectors of activity about which they might receive the commercial information or publicity;
- as a general rule, according to Act 34/2002, 11 July, on Information Society Services and E-commerce (E-commerce Act), in order to send commercial communications by

[45] Please see Legal Report 0454/2009 in Spanish at https://www.agpd.es/portalwebAGPD/index-ides-idphp.php.

electronic means, express consent must be previously obtained. As an exception to the general rule, express consent does not need to be obtained when there is a previous contractual relationship, provided that the sender legally obtained the recipient's data, and that communications refer to products or services of its own company that are similar to those that were the object of the contract. Also, when obtaining consent, individuals must be informed of an easy and free means of objecting to receiving commercial communications, which must be an email or other valid electronic address when the commercial communication is sent by email;

- in addition, according to the E-Commerce Act, commercial communications sent by electronic means need to fulfill certain requirements: they must include the referred-to easy and free means to object to receiving further commercial communications; they must be clearly identifiable as commercial, as must the entity or person on whose behalf they are sent; when they refer to promotional offers (e.g., discounts, prizes, gifts) and quests or promotional games, they must clearly identify them as promotional offers, quests and games, and their conditions of access and participation must be easily accessible and expressed in a clear and unequivocal way; and they must comply with any applicable law;
- before sending commercial communications, and according to data protection legislation, companies must ensure that the recipient has not previously objected to receiving such communications. In this respect, companies can keep the minimum data necessary to identity the person that objected and adopt the necessary measures to avoid sending publicity to that person (internal data filings regarding objections). Additionally, there are external public lists of persons that generally object to receiving commercial communications.[46] Such external lists must also be consulted prior to carrying out a campaign, and when an individual objects to receiving commercial communications, the individual must be informed of the lists' existence;
- consumer and telecommunications legislation imposes certain additional requirements, especially with regard to commercial communications made by telephone, fax, and without human intervention; and
- the E-commerce Act also imposes certain obligations with regard to cookies. Such obligations have been interpreted by SDPA in its Guide on the Use of Cookies,[47] published in April 2013. In this respect, some sort of tacit consent for the use of cookies has been accepted, provided that the website inserts a banner including certain information on the use of cookies and a link to a cookie policy where certain, more detailed, information is provided.

Some digital CRM makes use of cloud-based solutions. Please note that, as a general rule, such providers will be data processors, and the relevant considerations referred to above will apply. Additionally, SDPA has issued a Guide for Clients Contracting Cloud Services,[48] which refers to some important aspects to be taken into account when taking on cloud-based services.

[46] Please see Lista Robinson at https://www.listarobinson.es/default.asp.
[47] Please see at https://www.agpd.es/portalwebAGPD/index-ides-idphp.php.
[48] Please see at https://www.agpd.es/portalwebAGPD/index-ides-idphp.php.

Sanctions

In the case of non-compliance with the specific requirements for digital CRM listed above, companies can be sanctioned with a fine of up to €300,000 in the case of data protection infringements (up to €600,000 if they refer to international transfers for which an authorization was not obtained), up to €150,000 for infringements related to the E-commerce Act requirements, up to about €600,000[49] in the case of breach of requirements imposed by the Consumer Act, and up to €2,000,000 in the case of infringements of the Telecommunications Act. Additional fines and sanctions might be applicable to specific cases.

For a detailed description of the applicable sanctions, please see section C above.

Russia

Key Definitions and Pillars

The main piece of national legislation is the Federal Law on Personal Data, dated 27 July 2006 (the Personal Data Law or the Law).[50]

The Personal Data Law defines *personal data* as any data related to a directly or indirectly identified or identifiable individual (*personal data subject*), including the relevant first name, middle name and last name; year, month, date and place of birth; marital and social status, welfare, education, profession and income.

Personal data processing is understood as any action (operation) or aggregation of actions (operations) with personal data, performed with or without computer equipment, including collection, recording, systematization, accumulation, storage, verification (updating and amending), extraction, use, transfer (dissemination, granting, access), depersonalization, blocking, deletion and destruction of personal data.

Operator is a state body, municipal body, legal entity or individual that on its own or in cooperation with another person organizes and/or performs processing of personal data, and also determines the goals of personal data processing, content of personal data to be processed, and actions (operations) performed with personal data.

Cross-border transfer is a transfer of personal data to the foreign state body, foreign individual or foreign legal entity situated in the territory of a foreign state.

Consent

Personal data may not be collected, retained, used, disseminated, or in any other way processed, unless the consent of the personal data subject is obtained or such actions are expressly authorized in a statute. There are no specific requirements for the form or manner in which consent must be obtained from data subjects. The only requirement is that consent has to be specific, informed and conscious.

Certain rules apply if consent is to be given in writing (e.g., for a cross-border transfer): e.g., written consent should include the full name of the personal data subject or its representative (specially authorized by the data subject); passport (or other ID) information; the name and

[49] The specific amount of the fine is €601,012.10.

[50] More data protection provisions can be found in the Constitution of the Russian Federation 1993; Federal Law No. 149-FZ of 27 July 2006, On Information, Information Technologies and Information Protection; the Russian Labor Code; and numerous by-laws and regulations.

address of the operator or of the person processing personal data in the name of the operator; the purpose of data processing; the list of personal data to which processing consent is granted; the list of actions that the operator can perform with respect to personal data; a description of data processing methods; the term of the consent; and the procedure for revoking the consent.

Importantly, it is only the data subject who can consent to the processing of the relevant data: i.e., even an operator who is legitimately processing data with the consent of the data subject cannot consent on behalf of the data subject to the processing of the data by a third party.

The personal data subject's consent, however, is not the only ground for processing personal data. Article 6 of the Personal Data Law provides for a number of grounds other than consent for personal data processing. In particular, personal data processing can be performed without consent on the following grounds:

i. if personal data processing is necessary for conclusion or performance of a contract under which the personal data subject is a party, beneficiary or surety;
ii. if personal data processing is necessary for purposes provided for by an international treaty of the Russian Federation or by law, and also for performance by the operator of its functions, powers and duties required by Russian legislation; and
iii. if the personal data being processed was provided for general access by the public by the personal data subject or upon his or her request; and
iv. in some other specific cases.

Special Categories of Data and Biometric Data

The Personal Data Law specifically establishes particular protection requirements for special categories of personal data and also biometric personal data.

Special categories of personal data[51] include those that relate to the individual's race, nationality, political views, religious or philosophical beliefs, health and intimate life.

Biometric personal data is defined[52] as data defining physiological or biological features of a person, based on which the person's identity may be disclosed. It is understood that biometric personal data includes records containing data on distinguishing features of a person, fingerprints, and photographic images of a person in any form – printed, digital, or other.

The Law provides for a very limited number of grounds on the basis of which the special or biometrical personal data may be processed; among others, the prior written consent of the data subject, issued in accordance with the specific requirements of the Law.

Cross-border Data Transfer

The rules regulating cross-border transfer of personal data are in Article 12 of the Law.

The Law distinguishes two types of countries that personal data is transferred to:

i. countries that provide adequate protection for personal data: i.e., those that are Member States to the 1981 Council of Europe Convention for the Protection of Individuals with regard to Automatic Processing of Personal Data. Roskomnadzor may recognize other countries as providing adequate protection of personal data, but, to date, we are not aware

[51] Article 10 of the Personal Data Law.
[52] Article 11 of the Personal Data Law.

of any such recognition. Consent of a data subject to transfer personal data to such a country is required, but it can be obtained in any form; and

ii. countries that do not provide adequate protection for personal data, which is all other countries. Prior written consent of the data subject, issued in accordance with the specific requirements of the Law, is required for cross-border transfer of personal data to these countries.

Cross-border transfer of personal data is also allowed without written consent; in particular, for performance of a contract to which the data subject is a party. The written consent requirement should also not apply if data subjects transfer their personal data abroad themselves – e.g., via telephone or email.

Personal Data Information System

It is understood that personal data collected by personal data operators is processed by means of personal data information systems. The Personal Data Law defines a personal data information system (PDIS) as a collection of personal data contained in databases, as well as information technologies and technical means allowing processing of such personal data.

As a general rule, it is understood that a PDIS is any type of a database, in any form, which contains the personal data collected and processed by a personal data operator, as well as any other technical and other means (hardware, software) used for the personal data processing. The Law and the relevant by-laws provide numerous requirements for PDIS's security (in particular cases, including licensing) under which the operators have to ensure that the equipment and software used for the data processing comply with the applicable regulations.

Notification

Article 22 of the Personal Data Law establishes a mandatory requirement for operators to notify Roskomnadzor of the operator's personal data processing activities, which must be done before the actual start of the personal data processing.

Such notification should specify the company name and address of the operator; the purpose of personal data processing; the categories of personal data processed; the legal grounds for personal data processing; the information on providing security of personal data in accordance with the personal data protection requirements established by Russian Government; etc.[53]

There are several exemptions from the notification requirements:[54] e.g., if personal data:

i. is processed in accordance with the labor law of the Russian Federation;
ii. is received by an operator in connection with execution of a contract to which the data subject is a party; however, this applies only if personal data is not distributed and not provided to third parties without the data subject's consent, and is used by the operator only for performance of that agreement and execution of agreements with the data subject;
iii. is made public by the data subject; and
iv. includes only family names, first names and patronymics of the data subjects.

[53] A standard form of notification may be found on the official website of Roskomnadzor at http://rsoc.ru. An English version of the website is available at http://eng.rkn.gov.ru/.
[54] Article 22(2) of the Personal Data Law.

There are other exemptions that apply in relation to specific features of the data processing activities performed.

Requirement to Assign a Person Responsible for Organization of Personal Data Protection

Every operator–legal entity must assign a person to be responsible for organization of personal data processing.[55] Such a person can be an individual or a legal entity, and should receive instructions directly from the executive body of the operator and be accountable to it.

Security Measures

All operators of personal data in Russia must formally implement several internal policies and guidelines regulating processing and protection of personal data. In particular, these include:

i. personal data policy;
ii. list of confidential data;
iii. list of data protection equipment and software used; and
iv. agreements with third parties to which personal data of employees and/or non-employees is transferred.

In general, Russian rules for personal data protection are fairly complicated and should be assessed after a factual evaluation of the specific circumstances at issue.

Criteria for Application

The Personal Data Law is applicable to all government and non-government agencies, as well as all individuals, regarding collection, processing or use of personal data in Russia. The Law applies to foreign entities that have representative or branch offices in Russia. Currently, the Law is not interpreted to have extraterritorial action. Nevertheless, Russian authorities are close to adopting a bill under which any company that collects information about Russian citizens online will be required to store that information on servers in Russia (see 'Trends and Developments – Looking to the Future', below).

Regulatory Requirements Applicable to the Digital Dimension

All the requirements identified above are applicable to digital CRM in Russia. However, under the current approach, the Personal Data Law does not apply to foreign entities that do not have any legal presence in Russia. Therefore, websites operated by foreign legal entities having no presence in Russia are theoretically brought out of the scope of the Law. The situation may change in 2016, if Russian authorities adopt the bill under which any company that collects information about Russian citizens online will be required to store that information on servers located in Russia (see 'Trends and Developments – Looking to the Future', below).

Sanctions

In the case of non-compliance with the requirements for digital CRM referred to above, companies can be sanctioned with administrative fines and suspension of activities. Responsible officials may be subject to administrative fines and/or criminal liability (although the risk of

[55] Article 22.1 of the Personal Data Law.

criminal liability is rather theoretical). For a detailed description of applicable sanctions, please see Section C above.

2. North America

The U.S.

Main Principles

The main substantive privacy law requirements in the U.S. are to provide notice of privacy practices in accordance with CalOPPA; to implement appropriate security measures and ensure service providers comply with these requirements, under various state data security laws; and to obtain consent from data subjects in the event that their personal information will be used in a materially different manner than disclosed to them at the time of collection.

Otherwise, there is generally no consent requirement pursuant to U.S. privacy regulations.

Direct marketing laws, however, have varying consent requirements, depending on, e.g., the medium, and the state of residence of the customer.

Email, one of the most common forms of digital marketing, operates under an opt-out regime in the U.S. but strict content and procedural requirements also apply under CAN-SPAM.

Marketing via text messaging is subject to express affirmative consent, and other strict content and procedural requirements, under several federal and state laws.

There are no data protection authority registration requirements or cross-border transfer restrictions pursuant to U.S. privacy regulations.

While there is no uniform definition of “personal information” under the various U.S. federal and state laws governing privacy and direct marketing, generally “personal information” in the online world refers to the data subject’s name in combination with another identifier (e.g., address, email, phone number). Sensitive information is generally defined as a name in combination with a social security number, credit card number, financial account number or driver’s license number, under state data breach notification laws.

California and Florida’s data breach notification laws also consider a username and password for an online account to be sensitive information, which may trigger data breach notification obligations in the event of an unauthorized disclosure.

Health information is also considered sensitive under various state laws, and under federal law, pursuant to the Health Insurance Portability and Accountability Act (HIPAA), but that is outside the scope of this chapter.

Criteria for Application

Since the U.S. takes a sectorial approach to privacy regulation, the context of the data collection determines the law or laws that may apply (i.e., children’s privacy is governed by COPPA, health privacy is governed by HIPAA, etc.).

The location of the data subject is also relevant to the jurisdictional analysis, such that collecting information about, e.g., a resident of California would trigger the application of the privacy laws of that state. Similarly, the jurisdictional reach of U.S. direct marketing laws is based on the place of residence of the recipient of the marketing communication.

Regulatory Requirements Applicable to the Digital Dimension

Given the regulatory context outlined above, a digital CRM initiative in the U.S. should take into account the following data privacy, security and direct marketing requirements:

- online collection of personal information for CRM activities should be appropriately disclosed to website visitors in a privacy policy that complies with CalOPPA;
- when personal information is shared with affiliated and/or unaffiliated third parties for their own marketing purposes, an opt-out right should be provided to customers. Otherwise, the company would need to comply with the specific disclosure and reporting obligations of the California Shine the Light Act;
- a written information security program should be put into place to cover personal information collected for the digital CRM;
- the storage of sensitive information in the digital CRM, including payment information, should be avoided. Otherwise, such sensitive information should be encrypted in transmission and storage, and an appropriate data incident response plan should be developed;
- digital CRM service providers should agree to written security terms for personal information;
- the collection of personal information from children should be avoided on general audience sites, and child-directed sites should comply with COPPA's strict notice, consent and procedural requirements, including limitations around advertising to children;
- any privacy disclosure and opt-out requirements in agreements with advertising and other marketing providers should be observed; and
- marketing opt-outs should be managed effectively and opt-in consent should be obtained where required (e.g., text messaging marketing).

Sanctions

Non-compliance with the regulations identified above can subject violators to regulatory sanctions, fines, government investigations, private rights of action, and, in some cases, criminal penalties.

The fines can escalate quickly. In the case of, e.g., CAN-SPAM, each email sent in violation of it triggers a US$16,500 penalty.

Even in cases where FTC settles with a party, with no admission of guilt, these settlements usually come with an extended 10-20-year supervisory and audit period, and can lead to further findings of violations and to penalties.

For a detailed description of the applicable sanctions, please see section C above.

3. Latin America

Brazil

There is no specific law governing privacy/data protection in Brazil. Rather, the legal protection afforded to personal data arises from general rules and principles disseminated in several different pieces of legislation. As a result, there are no specific definitions of data controller, data processor, sensitive data and the like.

Nevertheless, as an individual's right to intimacy, privacy, honor and image is considered a fundamental right subject to protection by the Brazilian Federal Constitution, any use of personal data, including the collection, processing, storage, disclosure and transfer thereof, must be made in a way that the rights of intimacy, privacy, honor and image of the data subject are not infringed, under penalty of payment of indemnification for material and/or moral damages arising from such infringement.

Furthermore, the Brazilian Civil Code treats the right to privacy as a personality right, which cannot be waived or assigned, as a matter of public policy. The Brazilian Civil Code further sets forth that the use of one's name and image in a way that affects the person's honor, good fame or respectability, or for commercial purposes, is subject to mandatory previous consent.

Additionally, the CDC provides for certain rules regarding the storage and use of consumer data. In the absence of specific privacy laws, the principles and concepts of the CDC may apply by analogy to other types of relationships. In general terms, the CDC requires a supplier of products or services to have previously informed the consumer about the storage of personal information in databases, if the consumer did not request such storage. The CDC also provides that consumers should have the right to access any information about them stored in databases, as well as the relevant source of such information; and if any inaccurate information is stored in such files, consumers also have the right to require the correction of such information.

Also, the Internet Legal Framework has been passed (in April 2014). This law generally provides for principles governing use of the internet in Brazil, and dedicates a chapter to the protection of logs, personal data and private communications. According to the law, any collection, use, storage and processing of personal data requires the data subject's express consent.

In view of the above, and despite the lack of any express requirements, a more conservative approach is recommended: i.e., always obtain the express consent of Brazilian individuals in order to collect, use, treat, process and transfer personal data. The consent should include:

i. clear and complete information on the purposes for which the company intends to collect information;
ii. to whom data may be disclosed;
iii. where data will be stored (indicating if cross-border transfers are necessary/envisaged); and
iv. what means are used to protect it.

Further, there are no provisions that specifically address consent requirements. In principle, consent for the use, including without limitation, the collection and processing of personal data may be provided electronically, but it is advisable to adopt an opt-in system in order to obtain the data subject's consent. Electronic consent mechanisms are generally enforceable in Brazil, and considered sufficient to evidence the data subject's agreement with the terms of a consent form, to the extent that the data controller is able to prove that the systems and processes used to secure the consent are robust and reliable for the purposes of establishing the authenticity and integrity of the consent.

Note that there are also no specific rules in Brazil regarding international transfers of personal data. Nevertheless, to the extent possible and based on the constitutional protection of privacy and the rules of the CDC, it is advisable to include specific reference to international data transfers in the consent to be obtained from the data subjects.

Identically, there are no specific rules addressing notification obligations. However, as data controllers are generally liable for any data security breach, it is highly advisable to inform the affected data subjects as soon as the data controller becomes aware of a data security breach. In these situations, early notice can be helpful in mitigating possible damage to the data subjects (e.g., by allowing the data subjects to change passwords or take other precautionary measures to avoid damages).

In general terms, there is no specific requirement regarding security measures for the protection of personal data. However, in the event of unauthorized access to data, or unauthorized use or transfer of data, the data controller may be held liable for both material and moral damages, based on the Federal Constitution, the Civil Code and the CDC.

Criteria for Application

As mentioned above, in Brazil there is no specific privacy law and, in the absence of such, the provisions of different pieces of legislation may apply (e.g., the CDC and the Internet Legal Framework), either as guidelines or by analogy.

Regulatory Requirements Applicable to the Digital Dimension

To the extent any collection, processing, storage, disclosure and transfer of any personal data is envisaged to perform such CRM activities, entities should comply with the general privacy rules provided by the Federal Constitution, the Civil Code, and the CDC (including e-commerce regulation) and the Internet Legal Framework.

In addition to the specific provisions mentioned above, there are a few other regulations that may impact CRM activities, as explained below.

Marketing Emails

A Code of Self-Regulation (the Code) aimed at the responsible, ethical and correct use of marketing emails has been published by a council formed by representatives of 14 civil society organizations. It is important to note that the Code is not a formal law. However, it provides important guidelines on how marketing emails can be sent without breaching Brazilian privacy requirements. In addition to other provisions, the Code requires the parties to provide a "Privacy and Data Use Policy" on their respective websites, under penalty of, e.g., recommendation of blockage of the sender's domain name. The Code adopted an "opt-in" system, according to which non-requested messages are considered ethically incorrect. The only exception to this is when the parties have a longstanding commercial relationship that implies the concept of the so-called "soft-opt-in". The Code also contains other requirements that must be observed, including the identification of the sender and the nature of the email in the subject field.

In addition, the Code provides that the user's option to unsubscribe must be complied with within two days when directly requested by the user through an unsubscribe link, or within five days when requested by other means. Furthermore, the company responsible for sending marketing emails must use its own domain name. In the case of violation of any of the Code's provisions, sanctions shall be applied by an ethics committee formed by the Self-Regulation Code Council.

Do-not-call List

Although this is not specifically applicable to online CRM activity, note that in the state of São Paulo, State Decree No. 53,921, of 30 December 2008, created the Telemarketing Enrolment List to Blocked Calls, regulating State Law No. 13,226, of 7 October 2008. This legislation benefits users of fixed and mobile telephony with area code numbers from the state of São Paulo. The Consumer Defense and Protection Foundation (PROCON) is responsible for the maintenance and implementation of such a list, which is available through the internet or in local services centers of the state of São Paulo.

After 30 days of the consumer's inclusion in the list, telemarketing companies are no longer allowed to call the numbers included, unless the consumer grants prior permission in writing and with an express expiration date. Companies that fail to comply with the rules of State Decree No. 53,921 may be subject to administrative penalties set out in the CDC.

Currently, the laws regarding the do-not-call list are on a state-wide basis. Nevertheless, the Federal Union is already studying the creation of a national telemarketing register, under which only consumers that expressly give their consent may receive advertising through calls, SMS and email.

Sanctions

In general, non-compliance with privacy rights may entitle the data subject to indemnification for material and/or moral damages arising from the infringement. Further and specific consequences may be provided in the specific laws.

In a nutshell, the damages/remedies that could arise are:

i. monetary damages (which damages will need to be evidenced by the plaintiff in the relevant complaint);
ii. damages for pain and suffering (the amount of which is generally determined by the judge at the judge's own discretion);
iii. orders to take any specific measures (e.g., cease infringing conduct); and
iv. daily fines for failure to comply with any court orders.

Mexico

Main Definitions and Requirements

Personal Data: any information that refers to an identified or identifiable individual is considered to be personal data, under the FDPL. The definition includes information of customers, suppliers, vendors, partners, employees, minors, competitors and other third parties.

Data Processing: this term refers to the whole life cycle of personal data, notably collection, use, handling, profiting, transferring, disposal, disclosure and storage. It is important to note that data protection rules apply to personal data held in hard and electronic copy, and to both manual and automated handling of data.

Data Controller: the organization that takes the decisions regarding how personal data will be processed is considered to be the data controller. Under the "Responsibility Principle'" embraced by the FDPL, a data controller is responsible for complying with the obligations and data protection principles under the FDPL, even if such data is transferred to a data processor, to any other entity within the corporate group of the data controller, or to a third party, whether located in Mexico or abroad.

Data Processor: the third party that carries outs data processing activities on behalf of the data controller, under a contract, is considered to be the data processor.

Processing Rules: an organization that processes personal data must limit the use of personal data to those activities that are necessary to fulfill the purposes for which the personal data was collected. Such purposes must be clearly stated in the privacy notice. Whenever possible, data controllers should anonymize the personal data; provide the data subject with the option to use a pseudonym or remain anonymous; and delete/anonymize personal data once the stated purposes have been fulfilled and legal obligations met.

Sensitive Personal Data: **t**his category comprises personal data that reveals racial or ethnic origin, present or future health conditions, genetic information, religious, philosophic or moral beliefs, union affiliation, sexual preference, and, in general, any information related to the intimate life of the data subject.

It should be noted that sensitive data may include any data that potentially affects intimate aspects of an individual's life, or information that, if wrongly used, may place the data subject in a dangerous situation or in a position of being subject to discrimination.

Express consent is required for the collection and transfer of this type of data. Fines that could be imposed if an entity fails to comply with the applicable rules are twice as much when breaches relate to sensitive personal data.

Financial and Personal Estate Data: this category encompasses personal data related to the data subject's property, rights or obligations that may be suitable for economic valuation. This information includes bank account information, credit card information and security numbers.

Express consent is required for the collection and transfer of this type of data.

Individual Rights: data protection rights are constitutional rights and, thus, subject to the maximum degree of protection. All data subjects are entitled to the following rights, known as ARCO Rights[56]:

- access: the right to access personal data stored by the data controller, and to obtain information regarding the data controller's processing practices;
- rectification: the right to rectify personal data when inaccurate or incomplete;
- cancelation: the right to request the deletion of personal data if the data is not being processed under the law or if it is no longer necessary; and
- opposition to data processing: the right to oppose the processing of personal data, either for a legitimate cause or in the context of a specific purpose.

Data subjects are also entitled to revoke, at any time, consent previously granted to a data controller to process their personal data.

Privacy Notices: data subjects are entitled to expect a reasonable level of privacy. This expectation is generally defined by the information that is contained in a privacy notice, presented by the data controller to the data subject. All privacy notices must include certain mandatory requirements.

[56] Applicable law provides for a number of privacy rights of the data subjects, capturing access, rectification, cancellation and opposition to data processing. These set of rights is usually referred to as ARCO Rights.

Cookies: there are specific rules that regulate the deployment of cookies. Consent of data subjects must be obtained before cookies can be used.

Consent: as a general rule, consent is required for the collection and transfer of personal data; express consent is only required:

i. for the collection and transfer of sensitive data; and
ii. for the collection and transfer of financial and personal estate-related data.

As an exception to the general rule, no consent is required for the transfer of data between a data controller and a data processor, as long as a data processing agreement is in place. The FDPL allows for express written consent to be obtained through technology means (including "I accept" buttons or boxes), as long as they are not previously selected.

Consent can be express or implied, but the appropriate form of consent will depend on the circumstances, expectations of the data subject, and sensitivity of the personal data. When the data subject gives consent, it is usually understood to only cover the identified purposes. New consent is required for purposes that have not been previously identified and consented to.

As to online/electronic consent, in Mexico it is permissible and deemed effective if properly structured and evidenced.

Regarding minors, while consent from minors is not specifically addressed in any law, the rule is that minors (people aged 17 or younger) are considered incapable of giving consent. Parents and legal guardians are allowed to provide consent on behalf of the minor.

Notice Requirements: an organization that collects personal data must provide data subjects with information about the organization's identity; the personal data being collected; the purposes of the collection; third parties to which the organization will disclose the personal data; the rights of the data subject; how to contact the privacy officer or other person who is accountable for the organization's privacy policies and practices; how to make an inquiry or file a complaint; and where to review any updates or changes to the privacy policies.

Registration/Notification Requirements: an organization that collects and processes personal data is not required to register or notify the data authority.

International Data Transfer: transfers of personal data (including international transfers) are, in general, allowed, provided the transfers and relevant purposes are mentioned in the privacy notice.

As a general rule, the data subject's consent is required, except when data is to be transferred among entities that belong to the same corporate group, provided that such companies:

i. operate under the same internal privacy policies and practices;
ii. such policies are binding and enforceable; and
iii. such policies comply with the FDPL and the regulations.

If personal data is transferred to any other third parties that are unrelated to the transaction, express consent of the data subject is required, as well as full disclosure in the privacy notice of such transfers, the industry in which the third parties operate and the purpose of the transfer. It is also necessary to inform the data subject if the data transfer is not necessary for complying with or maintaining obligations under the agreement between the data controller and the data subject.

Data Protection Department: under the FDPL, data controllers must create within their organization a data protection role, which can be held by a department or else by a privacy officer. There are no specific requirements for the data protection department to reside in Mexico, to the extent that such a department may have the ability to perform the obligations set forth by the FDPL, regulations and guidelines; particularly the ability to receive and process data protection ARCO rights requests. Lack of a data protection department could be considered a breach under the FDPL, and penalties could therefore be imposed.

Security Requirements: organizations are required to take steps to ensure that personal data in their possession and control is protected from unauthorized access and use. Organizations shall implement appropriate physical, technical and security safeguards to protect personal data, and ensure that the level of security is commensurate with the amount, nature, and sensitivity of the personal data involved.

Criteria for Application

The FDPL applies to any individual or entity having a legal domicile or local office or branch in Mexico, or where the processed databases are located in Mexico. Further, the FDPL should apply to data controllers based in foreign countries if, in order to process data, they make use of means located within the Mexican territory.

In Mexico, organizations are required to conduct privacy impact assessments prior to the implementation of new information systems and/or technologies for the processing of personal data. Subject to regulatory guidance, organizations may be required to furnish evidence relating to the effectiveness of the organization's privacy management program to privacy regulators.

Regulatory Requirements Applicable to the Digital Dimension

Organizations that responsibly manage privacy, and educate customers about their privacy policies and practices, generally obtain great benefits, especially with regards to positive brand development. If an organization operates a website that has the potential to collect personal data from minors, it should consider technology and security methods to establish the ages of users and/or provide options for parents and legal guardians to file an online parental form. Organizations definitely don't want to fall afoul of the law on this one.

Organizations should also consider consent general rules. An organization that plans to engage in direct marketing activities with a data subject is required to obtain the data subject's prior consent, which cannot be inferred from a data subject's failure to respond.

Likewise, organizations should keep in mind at all times the principles set forth by the FDPL, particularly the "reasonable expectation of privacy" and the principle of '"information". In this regard, spam is significant. When implementing anti-spam filtering, organizations should not fail to inform employees and customers of monitoring and recording activities that may occur.

Opt-in and opt-out polices should also be kept in mind. Part and parcel of any comprehensive CRM and privacy policy is determining whether a website needs to consider an opt-in or opt-out approach to consent, depending on the targeted jurisdictions, the purposes of collection of personal data and the activities that will be performed afterwards.

Sanctions

Failure to comply with data privacy laws can trigger authority investigations and audits, complaints, administrative fines and penalties, civil actions, criminal responsibilities and/or private right actions.

For a detailed description of the applicable sanctions, please see section C above.

4. The Asia Pacific

Australia

Key Definitions

Employee record: in relation to an employee, this means a record of personal information relating to the employment of the employee. Examples of personal information relating to the employment of the employee are health information about the employee and personal information about all or any of the following:

i. the engagement, training, disciplining or resignation of the employee;
ii. the termination of the employment of the employee;
iii. the terms and conditions of employment of the employee;
iv. the employee's personal and emergency contact details;
v. the employee's performance or conduct;
vi. the employee's hours of employment;
vii. the employee's salary or wages;
viii. the employee's membership of a professional or trade association;
ix. the employee's trade union membership;
x. the employee's recreation, long service, sick, personal, maternity, paternity or other leave; or
xi. the employee's taxation, banking or superannuation affairs.

Personal information: means information or an opinion about an identified individual, or an individual who is reasonably identifiable:

i. whether the information or opinion is true or not; and
ii. whether the information or opinion is recorded in a material form or not.

Sensitive information means:

i. information or an opinion about an individual's racial or ethnic origin; political opinions; membership of a political association; religious beliefs or affiliations; philosophical beliefs; membership of a professional or trade association; membership of a trade union; sexual orientation or practices; criminal record;;
ii. health information about an individual;
iii. genetic information about an individual that is not otherwise health information;
iv. biometric information that is to be used for the purpose of automated biometric verification or biometric identification; or
v. biometric templates.

Main Privacy Requirements

In Australia, there is no distinction between a data controller and a data processor.

Instead, the APPs apply to any organization that meets the "Australian link" requirements described below, and that collects or holds personal information.

The APPs are grouped into five sets of principles intended to reflect the "life cycle" of handling of personal information. They address:

i. the practices, procedures and systems that entities have in place relating to how they handle personal information;

ii. how entities collect personal information, including unsolicited personal information;
iii. how entities manage personal information, including how they use and disclose personal information, disclose information overseas, and how they use government identifiers;
iv. how entities ensure the integrity, quality and security of personal information; and
v. how entities deal with requests for access to, and correction of, personal information;

More specifically, an organization must comply with the following:

Privacy Policy: an organization must have a clearly expressed and up-to-date privacy policy that contains certain prescribed information, including the kind of personal information collected, how the organization handles privacy complaints, whether it discloses personal information to recipients outside of Australia and, where practical to do so, the countries in which such recipients are based.

Collection: an organization must not collect personal information unless the information is reasonably necessary for one or more of the entity's functions or activities.

Correction: an organization must take reasonable steps to correct personal information it holds if the organization believes that the information is inaccurate, out of date, incomplete, irrelevant or misleading, or if the individual to whom the information relates requests a correction.

Notice Requirements: an organization that collects personal information must take reasonable steps to provide data subjects with a collection statement at or before the time the information is collected (or as soon as possible thereafter if that is not practical). The collection statement must include various prescribed information.

Consent: there is no express requirement for an organization to obtain an individual's consent to collect personal information so long as the organization only uses that information for the purpose for which it was collected or for a related purpose (or directly related secondary purpose, in the case of sensitive information) that the individual would reasonably expect the information to be used for. Consent is required for any other use except in limited circumstances. Consent by the data subject must always be voluntary, informed, explicit and unambiguous. Consent can be express or implied. Consent can be withdrawn.

Sensitive Information: additional consent obligations apply when the personal information that is collected is sensitive information.

Direct Marketing: an organization must not use or disclose a data subject's personal information for the purpose of direct marketing unless certain exceptions apply (including that the data subject has consented). This requirement does not apply to the extent that the Spam Act 2003 (Cth) (Spam Act) or the Do Not Call Register Act 2006 (Cth) (Do Not Call Register Act) apply.

Under the Spam Act, commercial electronic messages (sent by SMS, MMS or email) can only be sent with the consent of the relevant recipient. They must also clearly identify the sender and contain a functional unsubscribe facility. Under the Do Not Call Register Act, telephone marketing is not permitted to numbers registered on the Do Not Call Register unless consent has been obtained.

Rights of an Individual: data subjects have rights of access to personal information, and rights to request the correction, deletion and/or destruction of their personal information.

Registration/Notification: there are no requirements to register, file or notify OAIC of any collection or processing of personal information.

International Data Transfers: if an organization discloses personal information to a recipient outside of Australia, it must take reasonable steps to ensure that the recipient does not breach the APPs. Unless an exception applies, if the recipient breaches the APPs, the organization that disclosed the information will be liable for any such breach.

There are two key exceptions:

- if the recipient to which personal information is disclosed is subject to a law or binding scheme that provides substantially similar protection as under the Privacy Act, and there are mechanisms for the data subject to enforce any such law or binding scheme; or
- consent is provided after the data subject has been informed that if consent is provided the organization will not be responsible for any failure of the recipient to protect the personal information in a manner consistent with the APPs.

Security: organizations are required to take steps to ensure that personal information in their possession and control is protected from unauthorized access and use; to implement appropriate physical, technical and organization security safeguards to protect personal information; and to ensure that the level of security is in line with the amount, nature, and sensitivity of the personal information involved.

Employees: employee records are given a limited exemption from coverage under the Privacy Act. This exemption effectively allows private employers to use information concerning their employees for appropriate internal purposes, where

i. the organization is acting in its capacity as a current or former employer of an individual;
ii. the use of employee information is directly related to a current or former employment relationship between the employer organization and the individual; and
iii. the use of employee information is directly related to an employee record held by the employer organization and relating to the individual.

This exemption does not apply to contractors, subcontractors, consultants and company directors, who are considered to be outside of the employment relationship.

Criteria for Application

The Privacy Act extends its operation to any act done, or practice engaged in, outside of Australia by an organization that has an Australian link. This includes Australian entities, as well as any organization that carries on business in Australia, and the personal information collected or held by the organization in Australia, either before or at the time of the act or practice.

The OAIC guidelines provide that the term *carrying on business in Australia* is to be interpreted broadly. An entity may carry on business in Australia despite the bulk of its business being conducted outside Australia, or the entity not having a place of business in Australia, provided there is some activity in Australia that forms part of the entity's business.

For example, OAIC considers that an entity that has an online presence but no physical presence in Australia and:

i. the entity collects personal information from individuals who are physically in Australia (regardless of where the collecting entity is located);
ii. the entity has a website that offers goods or services to countries including Australia;
iii. Australia is one of the countries on the drop-down menu appearing on the entity's website; or

iv. the entity is the registered proprietor of trademarks in Australia

and it also carries on business in Australia. This means that even if a company has no local presence in Australia, it will be subject to the Privacy Act to the extent it collects personal information from Australian individuals. This broad interpretation of "carrying on business in Australia" goes beyond the meaning given to this term by other Australian laws, such as tax and corporation laws.

The investigatory provisions of the Privacy Act have extraterritorial operation in so far as they relate to complaints and investigations concerning acts and practices to which the Privacy Act extends.

Exemptions to the Privacy Act apply in respect of acts or practices:

i. of individuals only for the purpose of or in connection with their personal, family or household affairs, or otherwise other than in the course of a business carried on by that individual;
ii. of small businesses with a turnover of A$3 million or less (except those that are related to an entity that has a turnover greater than A$3 million, provide a health service, or satisfy other criteria specified in the Privacy Act);
iii. relating to employee records; or
iv. undertaken overseas and that are required by foreign laws.

Regulatory Requirements Applicable to the Digital Dimension

Organizations must take reasonable steps to implement practices, procedures and systems to ensure they comply with the APPs and can deal with inquiries or complaints about their compliance with the APPs.

An organization is expected to take an active role in monitoring its privacy handling practices, including determining whether information it holds is still required for the purposes for which it was collected, the accuracy of that information, and whether the use of identifiable information is necessary for an organization's intended purposes or if de-identified information could instead be used. Information that is no longer required should be destroyed or de-identified.

From an Australian privacy law perspective, particular areas of focus for conducting any business or CRM online include ensuring:

- accurate collection notices are provided to data subjects either at, before, or (if not practicable) as soon as practicable after the organization collects their personal information;
- a privacy policy is in place that accurately reflects the organization's operations, including the type of personal information it collects and holds, and the purpose for which it collects, holds, uses and discloses personal information; and
- compliance with Australian law by offshore entities targeting customers in Australia, given the extra-jurisdictional application of the Privacy Act.

Sanctions

For a detailed description of the applicable sanctions, please see section C above.

China

Definitions

As mentioned in section C, the concept of data protection/privacy exists under various laws and regulations the subject matter of which is not data protection/privacy. These data protection/privacy provisions are broadly and vaguely drafted, and the meaning of the same term used in various laws and regulations is not necessarily the same.

Generally speaking, however, "personal data" refers to information such as name, sex, occupation, education, contact means, marital status, income and property, fingerprints, blood type, medical history and other information that is closely related to an individual and his or her family. Please also note that PRC law does not specifically regulate data processors. Therefore, there is a risk that a data user will be liable for any non-compliance on the part of the data processor or that the two may be jointly liable for any non-compliance.

Notification and Consent Requirements

Pursuant to the NPC decision and the amended PRC Consumer Protection Law, data subjects should be explicitly informed of the purposes, scope and manner of personal data collection and use (including cross-border transfer), and their consent to this needs to be obtained.

Consent can be obtained orally or in writing. For evidentiary purposes, however, we would suggest obtaining consent by asking the individuals to take some explicit action to indicate their consent (e.g., by checking a tick box and submitting the form) or in writing. As the general population in China is not proficient in English, the relevant privacy notices/policies, etc., should be provided in Chinese, such that an informed consent can be obtained from the individual.

Security Requirements

Both the amended PRC Consumer Protection Law and the NPC decision require companies to adopt technical and other necessary measures to ensure that the personal data is secure and to prevent data leakage or loss. Companies are also required to take remedial steps immediately that data disclosure, damage or loss occurs or may occur.

Cross-border Transfers

Generally speaking, transfers of personal data out of China are permitted, as long as the consent of the data subject has been obtained and the data to be transferred is not "prohibited information". There are, however, specific restrictions for certain industries, such as the financial sector.

Criteria for Application

The PRC data protection/privacy rules are meant to apply as long as the collection, processing, use and/or transfer of "personal data" of PRC citizens are involved.

Regulatory Requirements Applicable to the Digital Dimension

There are notification and consent requirements as well as security requirements.

Sanctions

For a detailed description of the applicable sanctions, please see section C above.

Hong Kong

General Definitions

Personal data is defined as any data relating directly or indirectly to a living individual from which it is practicable for the identity of the individual to be directly or indirectly ascertained, and that is in a form in which access to or processing of the data is practicable.

Data user means a person who, either alone or jointly or in common with other persons, controls the collection, holding, processing or use of the data. The brand owners will be considered as data users.

Data processor means a person who processes personal data on behalf of another person and does not process the data for any of the person's own purposes.

Direct marketing means the offering, or advertising of the availability, of goods, facilities or services; or the solicitation of donations and contributions for charitable, cultural, philanthropic, recreational, political or other purposes through direct marketing means.

Direct marketing refers to the sending of information or goods, addressed to specific persons by name, by mail, fax, electronic mail or other means of communications, or making telephone calls to specific persons.

Notification and Consent Requirements

A data user (i.e., the brand owner) is required to provide the data subjects (i.e., the customers) with certain information on or before collection of their data, such as purposes of collection and classes of transferees. This information need only be given to the data subjects.

Express consent is only required if the data user subsequently wishes to use the personal data for additional new purposes (i.e., purposes that were not previously notified to the data subjects.) While oral consent is possible, consent should be obtained in writing for evidential purposes.

Further, a consent-based regime is in place with respect to use of personal data for direct marketing. If a data user intends to use or transfer personal data for direct marketing purposes, it must provide additional information to the data subjects, such as the kinds of personal data to be used in marketing, the classes of marketing subjects and the classes of transferees. Express consent must be obtained before a data user may use personal data in direct marketing. For transfer of personal data in direct marketing, consent must be in writing.

The consent for new purposes and consent for direct marketing require explicit action from the data subjects. Therefore, silence or deemed consent do not constitute a valid consent.

Security Requirements

The PDPO requires a data user to take all practicable steps to ensure that personal data is protected against unauthorized or accidental access, processing, erasure, loss or use. However, the PDPO does not set out any specific security measures.

Also, data processors are not directly regulated under the PDPO, and the data user is fully responsible for the actions of its data users. Therefore, where a data user engages a data processor, it is required to adopt contractual or other means to protect the personal data.

Cross-border Transfer

The PDPO prohibits transfer of personal data outside Hong Kong (apart from in certain circumstances, including with the consent of the data subject). This provision is, however, not yet in force. Therefore, there is currently no prohibition on the transfer of personal data purely on the basis that it is a cross-border transfer.

Criteria for Application

The PDPO applies to the collection and use of personal data that takes place in Hong Kong or is controlled by a data user incorporated in Hong Kong (or whose principal place of business is in Hong Kong). Therefore, if the brand owner is or has an entity incorporated in Hong Kong, or if the brand owner collects personal data from persons in Hong Kong or for use in Hong Kong, it will be subject to the requirements of the PDPO.

Regulatory Requirements Applicable to the Digital Dimension

All the above requirements should be taken into account in the case of digital and online initiatives.

Sanctions

For a detailed description of the applicable sanctions, please see section C above.

Japan

Definitions

The term "personal information" as used in the Act shall mean information about a living individual that can identify the specific individual by name, date of birth, or other description contained in such information (including such information as will allow easy reference to other information and will thereby enable the identification of the specific individual).

The term "a personal information database, etc." as used in the Act shall mean an assembly of information, including personal information, as set out below:

i. an assembly of information systematically arranged in such a way that specific personal information can be retrieved by a computer; or
ii. in addition to what is listed in the preceding item, an assembly of information designated by a cabinet order as being systematically arranged in such a way that specific personal information can be easily retrieved.

The term "a business operator handling personal information" as used in the Act shall mean a business operator using a personal information database, etc., for its business; however, the following entities shall be excluded:

- state agencies;
- local governments;
- incorporated administrative agencies, etc.;
- local independent administrative institutions; and
- entities specified by a cabinet order as having little likelihood of harming the rights and interests of individuals, considering the volume and the manner of utilization of personal information they handle.

The term "personal data" as used in the Act shall mean personal information constituting a personal information database, etc.

The term "retained personal data" as used in the Act shall mean such personal data over which a business operator handling personal information has the authority to disclose, to correct, add or delete the content, to discontinue its utilization, to erase, and to discontinue its provision to a third party, excluding the data specified by a cabinet order as harming public or other interests if its presence or absence is known, and the data that will be erased within a period of no longer than one year that is specified by a cabinet order.

The term "person" as to personal information as used in the Act shall mean a specific individual identified by personal information.

Criteria for Application

Under the Act, the key criterion is whether or not the entity falls under the definition of "a business operator handling personal information". To fall under this definition, as understood from the definition above, the operator needs to use the database, which meets certain requirements. The governmental ordinance provides additional numeric criteria. Namely, for the regulations under the Act to apply, it is required that a business operator handles "a personal information database, etc.", and such database needs to include the personal information of 5,000 or more people for six months or more continuously.

The requirements under the Act shall only be applicable to "a business operator handling personal information". The key requirements are:

i. notification or publication of the purpose of utilization of the personal information (the purpose should be as specific as possible);
ii. necessary and appropriate supervision of employees and subcontractors; and
iii. restriction of provision of the personal information to a third party. In principle, the retained personal information should not be disclosed to a third party without consent. However, certain exemptions are provided in article 23 of the Act, such as in the case of joint utilization.

The right to privacy is another issue. This constitutional right belongs to each individual, and each individual may take action for compensation for damages or injunctive relief against a party infringing such a right.

Regulatory Requirements Applicable to the Digital Dimension

The main requirements to be considered in terms of online and digital activities are summarized as follows:

i. notification or publication of the purpose of utilization of the personal information (the purpose should be as specific as possible);
ii. necessary and appropriate supervision of employees and subcontractors; and
iii. restriction of provision of the personal information to a third party.

Particularly, if the personal information of customers was shared and used by other group companies, the above exemptions to the restriction relating to item (3) above should be considered.[57] In some circumstances,[58] it is strongly advisable that the third parties who share the

[57] In such cases, article 23(2) or 23(4)(iii), depending on the situation.

personal information be identified. The specific requirements to be applied should be assessed on a case-by-case basis.

In addition, in the case of a typical IT vendor that, e.g., just provides an IT service and is unaware of the contents of the information, the restriction of item (3) would not apply.[59]

Sanctions

For a detailed description of the applicable sanctions, please see section I.5 d) above.

Singapore

The key concepts under the PDPA to be taken into consideration are as follows:

Personal Data is data, whether true or not, about an individual who can be identified from that data, or from that data and other information to which the organization has or is likely to have access.

Personal data may therefore include the full name, identification number, photograph, mobile number or personal email address of an individual. However, it should be noted that the PDPA does not apply to business contact information (i.e., an individual's name, position name or title, business telephone number, business address, business electronic mail address or business fax number, and any other similar information about the individual) that is not provided by the individual solely for his or her personal purposes.

Organization refers to any individual, company, association or body of persons, corporate or unincorporated, whether or not formed or recognized under the law of Singapore; or resident, or having an office or a place of business, in Singapore.

Data Intermediary is an organization that processes personal data on behalf of another organization but does not include an employee of that other organization. Examples of activities carried out by data intermediaries are recording, holding, organization or retrieval services for and on behalf of another organization.

The PDPA prescribes the following broad obligations that all organizations are required to comply with in relation to the collection, use and/or disclosure of personal data. A data intermediary is only required to ensure compliance with the protection and retention obligations as set out below.

Consent

Personal data may be collected, used or disclosed only for the purposes for which an individual has given the relevant consent.

Consent can be obtained in a number of different ways, including in a written or verbal form. As good practice, an organization should obtain consent that is in writing or recorded in a manner that is accessible for future reference, e.g., if the organization is required to prove that it had obtained consent.

It is also necessary to allow individuals to withdraw consent, with reasonable notice, and inform them of the likely consequences of withdrawal. Upon withdrawal of consent to the collection, use or disclosure of personal data for any purpose, the organization must cease such collection, use or disclosure.

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[58] For both article 23(2) and 23(4)(iii).

[59] Article 23(4)(i).

Purpose Limitation Obligation

An organization may collect, use or disclose personal data about an individual for the purposes that a reasonable person would consider appropriate in the circumstances and for which the individual has given consent.

An organization may not, as a condition of providing a product or service, require the individual to consent to the collection, use or disclosure of his or her personal data beyond what is reasonable to provide that product or service.

Notification Obligation

An organization is required to notify individuals of the purposes for which it is intending to collect, use or disclose their personal data on or before such collection, use or disclosure of personal data.

Access and Correction Obligation

Upon request, personal data of an individual and information about the ways in which it has been or may have been used or disclosed within the period of a year before the request should be provided. However, an organization is prohibited from providing an individual with access if the provision of personal data or other information could reasonably be expected to:

- cause immediate or grave harm to the individual's safety or physical or mental health;
- threaten the safety or physical or mental health of another individual;
- reveal personal data about another individual;
- reveal the identity of another individual who has provided the personal data, and the individual has not consented to the disclosure of his or her identity; or
- be contrary to the national interest.

An organization is also required to correct any error or omission relating to an individual's personal data upon the individual's request. Unless the organization is satisfied on reasonable grounds that the correction should not be made, the organization should correct the personal data as soon as practicable and send the corrected data to other organizations to which the personal data was disclosed within a year before the correction is made (or, with the individual's consent, only to selected organizations).

Accuracy Obligation

An organization is required to make reasonable efforts to ensure that personal data collected by or on behalf of it is accurate and complete, if it is likely to be used to make a decision that affects the individual, or if it is likely to be disclosed to another organization.

Protection Obligation

An organization is required to make reasonable security arrangements to protect personal data that it possesses or controls, to prevent unauthorized access to personal data, unauthorized data collection, use, disclosure or similar risks.

Data Retention

An organization is required to cease retention of personal data, or remove the means by which the personal data can be associated with particular individuals, when it is no longer necessary for any business or legal purpose.

Cross-border Transfers

Transfer of personal data to another country is allowed only upon compliance with the requirements prescribed under the regulations, in order to ensure that the standard of protection provided to the personal data that is transferred be comparable to the protection under the PDPA. Exemptions may apply under the PDPC.

Openness Obligation

An organization is required to make available upon request information about its data protection policies, practices and complaints process.

It is also necessary to designate one or more individuals as a data protection officer to ensure that the organization complies with the PDPA, including the implementation of personal data protection policies within the organization. The business contact information of at least one such individual should also be made available to the public.

Criteria for Application

Every organization is required to comply with the PDPA in respect of activities relating to the collection, use and disclosure of personal data in Singapore.

As mentioned above, the term "organisation" covers natural persons, companies, associations and individuals, regardless of whether they are formed or recognized under the law of Singapore, or whether they are resident or have an office or place of business in Singapore.

The only categories of organizations excluded from the application of the PDPA are the following:

- any individual acting in a personal or domestic capacity;
- any employee acting in the course of his or her employment with an organization;
- any public agency; and
- any organization in the course of acting on behalf of a public agency in relation to the collection, use or disclosure of personal data.

For application of the SCA, an electronic message must have a Singapore link, which means any of the following:

- the message originates in Singapore;
- the sender of the message is:
    - an individual who is physically present in Singapore when the message is sent; or
    - an entity whose central management and control is in Singapore when the message is sent;
- the computer, mobile telephone, server or device that is used to access the message is located in Singapore;
- the recipient of the message is:

  - an individual who is physically present in Singapore when the message is accessed; or
  - an entity that carries on business or activities in Singapore when the message is accessed; and
- if the message cannot be delivered because the relevant electronic address has ceased to exist (assuming that the electronic address existed), it is reasonably likely that the message would have been accessed using a computer, mobile telephone, server or device located in Singapore.

Regulatory Requirements Applicable to the Digital Dimension

For digital CRM in Singapore, organizations should comply with the following regulatory requirements:

- collect, use and disclose personal data of consumers only for specified purposes;
- the specified purposes should be such that a reasonable person would consider appropriate in the given circumstances;
- where the consumer's personal data is intended to be transferred outside Singapore, the transferring organization should ensure that the recipient organization is bound by legally enforceable obligations to provide the same standard of protection to the personal data as under the PDPA;
- put in place consent withdrawal policies that do not restrict or prevent individuals from withdrawing consent;
- designate a data protection officer whose contact information is publicly available to Singaporean consumers and who can be contacted during Singapore business hours. Individuals seeking to access and correct the personal data in the possession of the organization should be able to approach the officer;
- ensure that the personal data is protected against unauthorized disclosure by adequate technical and administrative measures;
- before sending a marketing SMS or a making a marketing call, the organization should have checked with the relevant DNC register within the last 30 days to confirm that the number is not listed on the register, unless it has clear and unambiguous consent (preferably written) from the relevant consumer to send the SMS or make the call;
- when sending marketing messages to Singapore telephone numbers, in addition to the check of the relevant register, it is mandatory to (a) provide information on the individual or organization who sent or authorized the sending of the marketing message; and (b) not conceal or withhold the calling line identity of the sender of the marketing message;
- when sending commercial electronic messages, consent should be obtained from the consumer beforehand. A commercial electronic message is an electronic message where, considering the content, the presentation and where the links or contact information in the message go to, it can be concluded that the primary purpose of the message is
  - to offer to supply goods or services;
  - to advertize/promote goods or services;
  - to advertize/promote a supplier, or a prospective supplier, of goods or services;
  - to offer to supply land or an interest in land;

- to advertize/promote land or an interest in land;
- to advertize/promote a supplier, a prospective supplier of land or an interest in land;
- to offer to provide a business opportunity or an investment opportunity;
- to advertize/promote a business opportunity or an investment opportunity;
- to advertize/promote a provider, or a prospective provider, of a business opportunity or an investment opportunity;
- to assist/enable a person, by deception, to dishonestly obtain property belonging to another person;
- to assist/enable a person, by deception, to dishonestly obtain a financial advantage from another person; or
- to assist/enable a person to dishonestly obtain a gain from another person.

When sending unsolicited commercial emails in bulk, ensure that such emails contain:

i. an electronic mail address, an internet location address, a telephone number, a facsimile number or a postal address that the recipient may use to submit an unsubscribe request; and
ii. a statement to the effect that the recipient may use the electronic mail address, internet location address, telephone number, facsimile number or postal address, as the case may be, provided in the unsolicited commercial electronic message to submit an unsubscribe request, or a statement to a similar effect.

Such a statement should be clear and conspicuous, and in the English language. Sending of emails in bulk would occur if:

i. more than 100 emails containing the same or similar subject matter are sent during a 24-hour period;
ii. more than 1,000 emails containing the same or similar subject matter are sent during a 30-day period; or
iii. more than 10,000 emails containing the same or similar subject matter are sent during a one-year period.

Ensure that personal data is destroyed or anonymized after the legal or business purposes for which it was collected have been accomplished.

Sanctions

For a detailed description of the applicable sanctions, please see section C above.

Taiwan

Key Definitions

Personal data includes "the name, date of birth, I.D. Card number, passport number, characteristics, fingerprints, marital status, family, education, occupation, medical record, medical treatment, genetic information, sexual life, health examination, criminal record, contact information, financial conditions, social activities and other information which may be used to identify a natural person, both directly and indirectly", which generally covers any information that may be used to identify a biological person, either directly or indirectly.

Collection means to collect personal data in any form and way.

Processing means to record, input, store, compile, correct, duplicate, retrieve, delete, output, connect or internally transmit information for the purpose of establishing or using a personal data file.

Use means all methods of personal data use other than processing.

International transmission means the cross-border processing or use of personal data.

Collection, Processing and use of Personal Data

According to article 19 of the PDPA, collection or processing of personal data must come with one or more specific purposes and meet one of the following conditions:

- it is prescribed under the laws;
- there is a contract or quasi-contract between the collector and the data subject;
- the data subject has disclosed such information himself or herself, or the information has been legally publicized;
- it is necessary for the public interest for statistics or the purpose of academic research conducted by a research institution, provided that the information is processed by the provider or disclosed by the collector in a way that would not lead to the identification of a certain person;
- a written consent has been given by the data subject;
- the public interest is involved; or
- the personal data is obtained from publicly available resources, provided the information is not otherwise limited by the data subject on the processing, or the data subject has a more protection-worthy interest in prohibiting the processing and use of information.

According to article 8 of the PDPA, with limited exceptions, where the information is collected directly from the data subject, the data subject must be informed of the following items:

- name of the collector;
- purpose of collection;
- category of the personal data being collected;
- time period, geographic area, target and way of use of personal data;
- rights of the data subject under article 3 of the PDPA (i.e., request to inquire about, review, be provided with copy, correct or supplement, request to stop the collection, processing or use of, and request to delete the personal data according to the PDPA) and procedures to exercise such rights; and
- the impact on the rights and interests of the data subject if he or she chooses not to provide personal data.

According to article 9 of the PDPA, with limited exceptions, where the information is collected from a source other than the data subject, before processing of the information or at the time of first use, the data subject must be provided with a mandatory set of information,[60] including also the source of the information.

Personal data may be processed and used within the scope of the specific purpose(s) informed to the data subject to the extent necessary and reasonably related thereto.[61] However, the

[60] Items (1) to (5) under article 8 of the PDPA.
[61] Article 5 of the PDPA.

competent authority of the specific industry may restrict the international transmission of data in one of the following circumstances:

- where it involves major national interests;
- where international treaty or agreement specifies otherwise;
- where the destination country lacks proper regulations for the protection of personal data and it might jeopardize the rights and interests of the data subject; or
- where the international transmission of personal data is made indirectly to circumvent the PDPA.

If the use of personal data is beyond the specific purpose(s), it must meet one of the following conditions:[62]

- it is prescribed under the laws;
- it is to promote public interests;
- it is to prevent harm to the life, body, freedom or property of the data subject;
- it is to prevent harm to the rights and interests of other people;
- it is necessary for the public interest for statistics or for academic research conducted by a government agency or an academic research institution, respectively, provided that the information is processed by the provider or disclosed by the collector in a way that would not lead to the identification of a certain person; or
- a written consent of the data subject has been obtained.

The above-mentioned written consent must be a separate consent, and the data subject must be informed of the effect on his or her rights if he or she chooses not to consent, and such other purpose and relevant scope.[63]

The consent must be express and in writing. The consent can be given electronically (e.g., by email), as long as its integrity is guaranteed and it remains accessible for subsequent reference.

The information to the data subject can be provided by means of oral communication, written document, telephone, text message, email, facsimile, electronic record, or other methods sufficient to make the information readily available to the data subject.

Enforcement of Data Subjects' Rights

The data subjects have the right to inquire about, review, be provided with a copy of, correct or supplement, request to stop the collection, processing or use of, and request to delete his or her personal data, subject to the relevant requirements under the PDPA.

The PDPA sets a 15-day deadline for responding to the requests for inquiry, review or a copy of personal data, and a 30-day deadline for responding to requests for correction, supplementation, cessation of collection, processing or using, or deletion.

Third-party service providers

One who commissions a third party to collect, process or use personal data is required to exercise proper supervision over such third party, periodically verify the implementation status and document the results. If the third party violates the PDPA, the commissioning entity will be held liable.

[62] Article 20 of the PDPA.
[63] Article 7 of the PDPA.

The supervision shall include, at least, the following:

- predetermining the scope, types, specific purpose and period for collection, processing or use of personal data;
- security measures taken by the third-party service provider (see below);
- in the case that the third-party service provider further requests another party to perform the request, arrangements in place with such other party;
- notification to the commissioning agency and corrective measures to be taken in the event of the third-party service provider's, or its employee's, violation of the act, other personal data protection laws or the regulations and requirements thereof;
- if the commissioning agency reserves the right to further instruct the third-party service provider, such further instructions; and
- return of media containing personal data upon termination/rescission of the request, and deletion of personal data stored and held by the third-party service provider, as required for performance of the request as agreed to in the relevant contract.

If one of them complies with the requirements for collection, processing and use of personal data as outlined above, both will be considered to meet such requirements.

Security Measures to Protect Personal Data

According to Article 27 of the PDPA, one who keeps personal data files should adopt proper security measures to prevent them from being stolen, altered, damaged, destroyed or disclosed. The competent authority in charge of the specific industry may require a specific entity to promulgate a security plan.

Such security measures should include both technical and organizational measures, which may include the following:

- deploying staff for management and sufficient resources;
- defining the scope of personal data;
- risk assessment and management system for personal data;
- system for prevention of, reporting and response to incidents;
- internal management procedure for collection, processing and use of personal data;
- data security management and staff management;
- promotion of awareness and educational training;
- equipment security management;
- data security audit system;
- keeping record of use, tracking information and evidence; and
- continuous overall improvement of maintenance of personal data security.

If personal data is stolen, disclosed, altered or infringed in other ways, due to non-compliance with the PDPA, the data keeper is required to notify the affected data subjects of the facts and the measures taken to deal with the infringement.

The notification can be done orally, in writing, by telephone, via text message, email, fax, electronic document, or in any other manner to make it readily available to the data subjects.

If the costs involved in notification are huge, it may be done via the internet, through the news media or in another proper public manner, taking into consideration technological feasibility and protection of the data subjects' privacy.

Criteria for Application

The PDPA is applicable to all government and non-government agencies, as well as all individuals, for collection, processing or use of personal data in Taiwan. It also applies extraterritorially to the collection, processing or use of the personal data of a Taiwanese national outside Taiwan, but not to foreign entities that do not have any presence in Taiwan.

The following circumstances are excluded from the application of the PDPA:

- where an individual collects, processes or uses personal data for the sole purpose of personal or familial activity; and
- where audio-visual data is collected, processed or used in public places or for public activities and is not associated with the other personal data.

Regulatory Requirements Applicable to the Digital Dimension

All the requirements identified above are applicable to the digital dimension. However, the fact that the PDPA does not apply to acts outside Taiwan by foreign entities that do not have any presence in Taiwan may arguably narrow the PDPA's impact on the online world. For example, if a website and server are hosted overseas by a foreign entity without any presence in Taiwan that collects, processes and/or uses personal data collected via the website outside Taiwan, it may be argued that the PDPA is not applicable.

Sanctions

Criminal Liability

For collecting, processing or using personal data in violation of the PDPA – imprisonment for up to two years, detention and/or a fine of up to NT$200,000 (approximately US$6,740); if the violation is for a profit-seeking purpose, imprisonment for up to five years, plus a fine of up to NT$1,000,000 (approximately US$33,700).

For illegally impeding the accuracy of personal data files – imprisonment for up to five years, detention and/or a fine of up to NT$1,000,000 (approximately US$33,700).

This is only applicable to individual persons, not to legal entities such as companies.

Administrative Fines

For collecting, processing or using personal data in violation of the PDPA – a fine of from NT$50,000 (approximately US$1,685) to NT$500,000 (approximately US$16,850), which may be imposed repeatedly until the violation ceases.

For failure to inform the data subject of the required matters under the PDPA, to act in response to the data subject's exercise of rights according to the PDPA, or to implement proper security plans as requested by the competent authority, and not ceasing the violation after being requested to by the central or local authority – a fine of from NT$20,000 (approximately US$674) to NT$200,000 (approximately US$6,740), which may be imposed repeatedly until the violation ceases.

For evading, obstructing or refusing the compliance inspection conducted by the competent authority according to the PDPA – a fine of from NT$20,000 (approximately US$674) to NT$200,000 (approximately US$6,740).

If the company is fined, its representative or managerial person, or other person with representative authority, will also be fined in the same amount, unless such a person can prove that he or she has exercised his or her duty to prevent the violation.

Civil Liability

Where the data subjects' rights are damaged as a result of violation of the PDPA, they will potentially receive damages of NT$500 to NT$20,000 (approximately US$17 to US$674) per person.

This is applicable to the company. In addition, the responsible person of the company may also be held jointly and severally liable.[64]

III. Trends and Developments – Looking to the Future

This section contains some highlights of the main likely future developments and trends in the relevant regions: e.g., new laws or soon-to-be-in-force legislation, enforcement paths and trends that may have an impact on digital CRM.

1. Europe and Russia

France

According to CNIL's 2014 inspection program, priority is given to online inspections, cookies, banking data security and electronic communications operators.

CNIL's annual inspections program illustrates CNIL's technological and sector-specific priorities, independently of the approximately 6,000 complaints it receives each year and that may also trigger an inspection.

The first innovation in the 2014 program is that CNIL has decided to implement new online inspection powers, enacted by the Act of 17 March 2014 (the Act).

CNIL now has an online investigative power comparable to, or even greater than, the power conferred on it for on-site verifications. Indeed, these digital investigations are carried out without the possibility of exercising a right to object, without the website's manager being informed and, as such, without a report being prepared in the presence of all parties. As the Act states, online inspections apply only to data that is "*freely accessible*"; they do not allow CNIL to break through security measures. Thanks to this new power, which is quicker to implement while at the same time being less costly in terms of resources, CNIL announced a significant increase in its target number of inspections in 2014 (+33 percent, or 550 inspections in 2014 versus 414 in 2013).

Within this framework, pursuant to the terms established at the EU level by WP 29 (Article 29 Working Party, currently headed by CNIL[65]), CNIL intends to inspect websites' policies and practices on cookies. For the European authorities, including CNIL, this will involve evaluating the quality of information provided to internet users and the means for obtaining their consent. As no specific sectors are mentioned, these inspections will likely be conducted on a broad range of

[64] Paragraph 2, article 23 of the Company Act.
[65] For more information on the Article 29 Working Party, please see http://ec.europa.eu/justice/data-protection/article-29/index_en.htm.

websites. Similarly, CNIL will inspect "*the protection of privacy on mobile terminals*", i.e., tablets and smartphones, and, in all likelihood, whether the many applications, offered to users and that collect and process large quantities of personal data, are compliant.

The 2014 inspection program clearly shows that CNIL, acting as a national authority and as president of the WP 29, wishes to increase European and international cooperation between authorities to adapt to the fact that data flows are now transnational by nature. To this end, CNIL appears to wish to confer on the WP 29 a more operational inspection role, which moves it away from somewhat its original duties as a consultative body issuing opinions and recommendations.

When it performs online inspections, CNIL will probably also verify whether websites comply with their obligations regarding personal data and IT system security and, if applicable, will also evidence the online security breaches.

Banking Data and Banks

The second area of the CNIL program involves banking data and banks.

Indeed, taking into account the "*recurrent*" complaints it receives showing deficiencies in terms of banking data confidentiality and security, CNIL states that it wishes to "*raise awareness*" of the actors involved and "*verify*" application of its November 2013 recommendation on storing debit/credit card numbers. In addition to specifying the means for obtaining the customer's consent so as to retain his or her banking data, this new recommendation strengthens the security measures required of merchants. At the same time the recommendation encourages the said merchants to notify parties involved of all "*security breaches*" regarding their banking data in anticipation of future regulatory obligations. By committing, as of 2014, to monitoring the proper application of its recommendation from last November, CNIL wishes to send a strong signal that this recommendation is important and to warn the market that it does not intend to give companies more time to comply with it.

This inspection area should, technically, lead to both online inspections serving as security "tests" and ordinary on-site inspections. Potentially, all commercial sectors will be affected, including e-merchants, major brand names in distribution and brick and mortar stores, since collecting banking data is part of their daily business.

In the past, CNIL penalized merchants on several occasions, due to deficiencies in their security measures and excessive data retention. CNIL has announced that it wishes to devote "*a large number of inspections*" to this issue.

The banking sector will also be affected by CNIL's inspections because CNIL wishes to verify the functioning of the National Database on Household Credit Repayment Incidents (FICP). The FICP, which is under the Bank of France's authority, lists payment incidents, and banks directly provide information to it. However, for some time CNIL has reported failures in registering or removing the relevant persons from the database. This is the leading source of complaints involving the banking sector received by CNIL, which has already issued some sanctions on this basis.

The third inspection area involves electronic communications operators and data security. Since August 2011 and implementation of the "telecoms package", communication operators are required to notify CNIL and, in most instances, the affected persons, of security breaches involving personal data. As there have been many recent events involving security breaches, like the "Orange case" and the loss of 800,000 customers' data, CNIL wishes to verify that operators have the required internal processes and that they are compliant in performing their notice obligations. It should be noted that this issue was already included in the CNIL's 2013 inspection program.

Confronted with this ambitious program, which includes a new inspection form (online) and involves strategic banking data, companies have to take the necessary action to ensure that their data processing is compliant and consider the responses they will provide if they are inspected by CNIL.

Cooperation between CNIL and DGCCRF

CNIL and the Directorate-General for Competition, Consumer Affairs and Prevention of Fraud (DGCCRF) have decided to cooperate in order to protect consumers' personal data on the internet. This new cooperation allows the two organizations to exchange information in order to increase their controls and audits. Moreover, they have started a joint investigation of French e-commerce companies.

Class Action

The "Hamon" Act aims, in particular, to restore the balance of power between consumers and professionals. The introduction of a class action system under French law is the first step – after decades of debate, group actions are now possible under French law, under articles L. 423-1 to L. 423-26 of the Consumer Code. Based on an "opt-in" proceeding, and implemented only after a definitive decision by a competition authority, consumer associations will play a major part in these proceedings.

Only consumers can file a claim. These consumers have to be in a "similar or identical situation" and must have suffered a financial loss resulting from a material damage, caused by one or more professionals. Accordingly, physical or non-pecuniary damages are excluded from the scope of class actions. Two kinds of infringement are likely for a class action:

- the infringement of French or European law concerning anti-competitive practices; and
- the failure to perform, or the improper performance of, statutory or contractual obligations, committed during the sale of goods or the provision of services. The latter covers all consumer disputes.

New Guidelines for Cookies

In Deliberation no. 2013-378 of 5 December (the deliberation), CNIL revised the guidelines it had initially issued.[66]

In a more pragmatic interpretation of how to identify users' prior consent, CNIL now recognizes that consent (i.e., a freely given, specific and informed indication of a person's wishes) may result from the internet user merely continuing to browse the website, once the internet user is clearly informed of the use of cookies, their purpose and the possibility of opposing such use.

In addition, cookies may have a maximum lifespan of 13 months, as compared with six months under the former guidelines. After this period, consent must be obtained again.

[66] Following implementation of the provisions of Directive 2009/136/EC by order no. 2011-1012 of 24 August 2011.

A broad scope of tracking technologies are subject to regulation: not only are http cookies affected, but also flash cookies, invisible pixels (web bugs), identifications performed by calculating the terminal's fingerprint and hidden identifiers. It does not matter whether the stored or viewed information is personal data or not. The scope is very broad and includes, inter alia, advertising cookies, tracking cookies used in social networks, and cookies installed and read when viewing a website, reading an email or downloading an application or software.

The only cookies exempted are technical cookies, the only purpose of which is to permit or facilitate electronic communication, cookies that are strictly necessary for providing a service expressly requested by a user, and audience cookies that can verify certain criteria provided by the deliberation (most cookies on the market today do not meet these criteria).

How to comply in practice: internet users are now presumed to have consented to cookies being used if they continue to browse a website after having been clearly informed of (i) the use of cookies for certain specified purposes; and (ii) the ways in which to oppose such use. CNIL recommends the implementation of a two-step process:

i. a banner informing the internet user of the purpose of each cookie that may be installed (including third-party cookies), with a link to the practical ways to oppose such use, must appear on the website's homepage the first time the internet user visits the page and upon each new visit until the internet user "continues browsing" the website. This banner informs the internet user that continuing browsing will be deemed full consent to the defined use of cookies; and
ii. in the event the internet user wishes to control each cookie used, the user must click on the "more information" link provided in the banner and be provided with means to accept or reject the relevant cookies, with sufficient granularity to enable a distinction to be made between the various cookies, which have to be presented simply and legibly.

In practice, therefore, no cookie can be installed as long as the internet user has not continued browsing on the relevant website or clicked on the link in the banner to provide his or her preferences for each given cookie.

CNIL also provides, notably for third-party cookies, specific ways to inform internet users, such as displaying of icons directly on advertising banners to inform users of the identity of the advertising agency that may process their personal data.

There are risks of non-compliance. For example, if, once the banner is displayed, visiting/navigating to another page (another URL address) on the website, or expressing one's choice on the page that is accessible from the "more information" link, constitutes proof of consent to the installation of one or more cookies, given the current state of technology, such an approach cannot be fully implemented with all types of tracking technology, such as invisible pixels, Flash cookies or fingerprint technologies, which creates a risk of non-compliance for websites using such technologies.

Therefore, for these categories of technologies, which are often used by marketing companies, other technical means that satisfy the CNIL's new guidelines will have to be found.

Penalties for failure to comply with these new requirements have been reinforced by the "Hamon" Act. This Act increases the means of control and sanction of DGCCRF and CNIL.

In order to render their controls more efficient, the agents of DGCCRF will be able to use the "mystery" control method, and may defer the disclosure of their identity and/or use a fake identity.

DGCCRF can also, in specific cases, directly sanction professionals that infringe the applicable law and impose administrative sanctions (injunctions and administrative fines). Moreover, these sanctions can be published.

The "Hamon" Act gave CNIL the ability to perform online and non-contradictory controls. It can now detect remotely, unexpectedly, and without obligation to notify the relevant responsible of personal data, from a computer connected to the internet, breaches of the FDPA. Its findings will be recorded in a binding report sent to the organization concerned. From October, the CNIL has intended to monitor compliance with all of its recommendations, as part of its traditional on-the-spot inspection powers, but especially thanks to its new online control powers.

To check compliance with its recommendations and, more broadly, with the FDPA, CNIL plans to inspect the types of cookies used, their purpose, whether the web publisher is aware of the purpose of all the cookies placed on or accessed from its website, and the presence of "without purpose cookies", such as obsolete ones. Other provisions of the FDPA applicable to cookies (data security, sensitive data, etc.) may also be monitored. Where the use of cookies requires users' prior consent, CNIL will also examine the:

- collection of consents to the use of cookies (prior consent of user; means to allow user to express consent; usability of the means chosen);
- visibility, quality and simplicity of the information given;
- consequences if a user refuses cookies (e.g., if the only way an e-commerce site allows a user to prevent the use of cookies is if the user blocks all cookies at the browser level but this prevents the user from making online purchases);
- faculty for the user to withdraw consent at any time; and
- the maximum lifetime of cookies and the limit of validity of 13 months of the collected consent.

CNIL may, when non-compliance with French law is identified, issue warnings to, or even enforce sanctions against, the data controller.

Germany

In the future, it seems likely that data protection enforcement will be higher on the agenda of private entities. In Germany, cease-and-desist claims may already be brought by infringed parties. In other areas of law, cease-and-desist claims have become a major means to ensure the compliance of businesses. For example, private consumer protection associations are entitled to issue cease-and-desist claims against the usage of ineffective standard business terms.

The DPAs have been rather reluctant to enforce state-of-the-art organizational and technical measures to protect personal data. However, this seems to be changing in the light of foreign intelligence affairs and criminal attacks on businesses' IT infrastructure.

Only recently, the Bavarian DPA conducted an automated test of the email servers of over 2000 companies and issued orders against more than 700 companies whose email servers did not use strong encryption technologies.

New technologies, such as IoT, may have a significant impact on the luxury and fashion industry through products such as intelligent wearables, as well as self-operating stock management systems.

Businesses should prepare for more pressure to comply with applicable data protection laws. It seems possible that new bodies enforcing data protection regulations will appear on the scene and that the DPAs will get more and more active and stricter.

Technical and organizational measures of protecting personal data will become more and more important. To tackle this challenge, businesses should have data protection issues in mind when designing business models and planning data processing. In most cases, it is easy to comply with the law, and even improve customer confidence, unless data protection issues have been considered only after a system has been programmed – or a DPA has announced an audit or customers have raised complaints.

Data protection violations may cost money and it may be hard work to fix them in an existing environment. Again, though, compliance is often easy to achieve when considered at an early stage of a new business plan.

Italy

Starting with the inspection plan of the Garante for the second half of 2014,[67] it should be noted that it focuses, on the one hand, on issues that have already been present on the radar screen of the Garante; and, on the other hand, on new areas that present significant concerns in terms of the amount of data processed or conditions of processing.

Already-existing areas of attention include:

- big data in the public sector, especially welfare and financial agencies;
- management of public networks for access to the internet through wi-fi;
- direct marketing (i.e., marketing by telephone); and
- mobile payment.

Regarding new areas of interest of the Garante, the following items are worth mentioning:

- call centers located in non-EU countries;
- systems to profile customers – which, of course, is the core issue for CRM;
- pharmaceutical companies;
- centers for technical support and data retrieval; and
- data breaches.[68]

As to data breaches, please note that, as currently drafted, the Privacy Code provides for a duty to warn the Garante, and (under some instances) also the data subjects, in the case of data breaches. This obligation is addressed only to providers of publicly available electronic communications services.

Inspections and audits are usually performed by personnel working at the Garante, as well as in collaboration with a specialized department of the Italian tax police (*Nucleo speciale privacy della Guardia di finanza*).

As well as the planned investigation activities, there will, of course, be those triggered by claims and warnings received by the Garante.

[67] The plan is available on the website of the Garante at www.garanteprivacy.it.

[68] A *personal data breach* is defined under the Privacy Code as a security breach leading, accidentally or not, to the destruction, loss, alteration, unauthorized disclosure of or access to personal data transmitted, stored or otherwise processed in the context of the provision of a publicly available communications service.

CRM and Profiling Activities

Regarding CRM activities, the Garante is paying specific attention to the issue of profiling and, as highlighted in section C, how long profiling data is kept.

In the case of filing of a prior checking procedure or in the case of an investigation by the Garante of CRM activities, please note that the whole CRM structure is generally scrutinized, from the privacy documentation used for customers, to the management of the preferences expressed by customers, to data retention periods and relevant deletion/anonymization procedures, etc.

A specific notification to the Garante must be filed before starting profiling activities.

The fashion and luxury industry is therefore significantly affected by this enforcement trend, since, basically, any CRM activity is based upon profiling information about customers.

Cookies

The rules on cookies issued by the Garante will be enforceable by June 2015, and thereafter the Garante is likely to be screening internet and mobile websites for compliance.

As noted in section C above, the information requirement should be satisfied by an initial banner providing brief information, coupled with a more comprehensive privacy notice (the so-called cookies policy).

The initial banner should contain at least the following information:

i. the website makes use of profiling cookies in order to send advertising messages that are targeted to the user's preferences, if this is the case;
ii. the website makes use of third-party cookies, if this is the case;
iii. a link to the cookies policy;
iv. that in accessing the cookies policy, the user is enabled to refuse consent to all cookies for which consent is necessary under the law; and
v. that it is considered as acceptance of all cookies that the user continues browsing the website by accessing any other section of the website or by selecting any item on the website (e.g., by clicking any picture or link).

The long privacy notice (the cookies policy) should contain a detailed description of the different types of cookies, with particular focus on the cookies that are used on the relevant website. This description should detail, e.g., the following information:

i. the name of the cookies used;
ii. the purposes for which cookies are used;
iii. the kind of cookies used;
iv. the source of cookies used; and
v. the timespan of cookies used.

In the long privacy notice, the user should be given the ability to express easily their preferences as to cookies. This means that the user should be enabled to accept some of the cookies, as well as to refuse some or all of the cookies.

National and International Cooperation

As is the case with other European privacy authorities (e.g., CNIL in France), the Garante is fairly active in engaging in collaboration with other European privacy authorities.

The same trend may be observed in relation to other (non-privacy) authorities and international bodies, and associations dealing with privacy issues or with issues overlapping with privacy, e.g., consumer protection authorities, international privacy organizations.

The Garante, e.g., is part of GPEN,[69] which is an informal network of authorities with enforcement powers that has been established with the aim of easing and fostering cooperation among authorities at a cross-border level.

The privacy authorities of Australia and Switzerland, as well as the U.S. Federal Communications Commission (FCC) and the U.S. FTC, among others, participate in GPEN.

From 15 to 19 September 2014, the Article 29 Working Party[70] launched a coordinated assessment performed by privacy authorities of the most-visited European websites that are involved in e-commerce and media activities and target European users (the so-called "Cookie sweep day"). The aim of the assessment was to verify the compliance of said websites with applicable cookies regulations.

The ultimate goal of the Cookie sweep day was to conduct an assessment in relation to general European requirements regarding information and consent, while gathering information, on a comparative basis, about Member States' practices in relation to cookies. It was also aimed at fostering a certain degree of harmonization.

Of course, the privacy authorities that were involved may further make use of the results for enforcement purposes at a national level.

Call Centers

The Garante has always paid specific attention to the way in which individuals' personal data is collected and used by call centers.[71]

It should be noted that, in many cases, call center activities are outsourced to specialized third-party companies. In the majority of these cases, these third parties act as data processors, on behalf and under the instructions of the data controller. It is important to make sure that the individuals who call the call center, or receive a call from it, are duly informed of the privacy roles of the different parties that are involved in the delivery of call center services.

In addition, third-party service providers should be bound by clear obligations to use customers' personal details only to deliver the agreed services, making it clear that they cannot use said data for their own benefit or for any other purposes: e.g., to market their or other third parties' products and services, or to run their or other third parties' advertising campaigns.

Taking into account the information requirement, a brief recap of the main privacy terms and the identity of the data controller has to be given at the beginning of the phone call, as well as an

[69] For more information on GPEN, please see https://www.privacyenforcement.net/.
[70] For more information on the Article 29 Working Party, please see http://ec.europa.eu/justice/data-protection/article-29/index_en.htm.
[71] The regulation on call centers has been published in the Official Gazette of 7 December 2007 n. 285, available in Italian at http://www.garanteprivacy.it/garante/doc.jsp?ID=1462788; Law n. 134 of 7 August 2012, which has been implemented by Legislative Decree n. 83 of 22 June 2012 (the so-called *Decreto Sviluppo*), available in Italian at http://www.altalex.com/index.php?idnot=58504; the referenced law has been published in the Italian Official Gazette n. 187 of 11 August 2012, available in Italian at http://www.altalex.com/index.php?idnot=58504; Decision of the Garante N.582 of 18 December 2013, available in Italian at http://www.garanteprivacy.it/web/guest/home/docweb/-/docweb-display/docweb/2849324.

easy way by which customers may have access to the complete privacy notice. Pre-recorded messages may be used for this.

If consent is necessary under the Privacy Code, specific procedures should be in place to allow the collection of a valid consent and for the data controller to provide sound evidence of the fact that consent has been lawfully obtained.

For call centers that are located outside the EU, the Garante has specific rules, devoting particular attention to the means to be used so that the transfer of data outside the EU is lawful.

The rules set out by the Garante also apply to cases where subcontractors are used. It may indeed happen that first service providers are based within the EU while subcontractors are established in third countries, out of the safe EU boundaries.

There are also communications obligations to the Garante, as well as to labor authorities, in the case of outsourcing of call center activities, and there is a requirement, in some circumstances, to allow the customer to speak with an operator who is based in Italy – specific conditions apply, to be considered on a case-by-case basis.

Mobile Payment and NFC

Mobile payment and NFC (near field communication) are other areas to be monitored from a privacy perspective.

Indeed, the widespread use of mobile devices and the opportunities offered by new payment methods are likely to lead to a sharp increase in mobile-based means of payment. This is also due to the positive attitude of users, who generally find it convenient and faster to make use of mobile device for payment and instant-invoicing purposes.

The potentially remarkable amount of data that may be captured through such payments represents a risk, which is increased by the fact that payment takes place through mobile device.

A mobile device is, indeed, different from a traditional IT product (such as a personal computer), so different security measures that guarantee high security standards should be applied.

In addition, mobile payment solutions often rely on biometric data (e.g., fingerprints), instead of passwords, for authentication purposes. On the one hand, this guarantees that payment is authorized by the right person, limiting possible identity thefts. On the other hand, tighter precautions should be implemented, since in the case of loss or abuse of biometric data, the consequences for an individual are usually more significant.

Poland

From a Polish perspective, the main areas at issue appear to be video surveillance (CCTV) and international data transfers.

CCTV

Video monitoring and CCTV are not specifically regulated by Polish law. On 10 July 2014, the Ministry of Internal Affairs published new guidelines for the draft Monitoring Video Act. This is aimed to regulate, in particular, installation and operation of monitoring systems, control systems, and procedures for sharing copies of images and accessing them by authorized entities. If passed into law, the project will introduce a brand-new position – the Administrator of Monitoring Systems. The Act has separate rules for monitoring of the following areas: open spaces (streets, parks, squares), closed areas (shops, schools, workplaces) and private areas (areas used by the owner only for private purposes).

Each person will have a right to be informed about being under surveillance. Enforcement of the provisions of the new law is to be entrusted to the Polish DPA.

Trans-border Transfers

The Polish DPA is quite strict with respect to rules about international data transfers.

In particular, for recipients situated in countries outside of the EEC that do not offer adequate level of data protection, according to the Polish DPA, the mere inclusion of model contractual clauses is not a sufficient basis to legally transfer data. Thus, a data exporter must still apply for the consent of the DPA for a data transfer based on model contractual clauses approved by commission decision.

Spain

First, there have recently been some legislative changes that affect digital CRM.

These are:

i. a new General Telecommunications Act (Act 9/2014, 9 May), which introduces certain provisions with regard to users' rights that affect commercial communications;
ii. the modification of the E-commerce Act by the General Telecommunications Act, which affects certain articles regulating commercial communications and cookies; and
iii. the modification of the Royal Legislative Decree 1/2007, 16 November, by which the Recast Text of the General Act for the Defense of Consumers and Users and other complementary laws is approved, which also includes certain provisions with regard to commercial communications.

Privacy Impact Assessment

In the data protection field, SDPA has recently issued a draft privacy impact assessment template (PIA).[72]

This draft PIA aims to provide a template for companies to carry out analysis of new information systems, products or services that may give rise to risk in the data protection field. According to the introduction in the PIA, it is issued within the frame of the new European trend of "privacy by design". This could be of help in determining the data protection implications of marketing campaigns.

Sanctioning Trends

With regard to recent sanctioning trends of SDPA (an entity with faculties to impose sanctions in both the data protection and e-commerce fields), please note that, according to the Memorandum of SDPA for 2012, the number of sanctioning procedures due to infringements related to commercial communications increased 68.97 percent from 2011 to 2012, which may be an indicator of the recent tendencies of companies to infringe and SDPA's actions in order to stop such infringements.

[72] Please see in Spanish at https://www.agpd.es/portalwebAGPD/index-ides-idphp.php.

Regarding cookies, SDPA is already carrying out enforcement actions. In this respect, it has already resolved two cases, which ended with sanctions being imposed.

The main challenge in Spain is the high enforcement activity of regulators, especially SDPA, which imposes a very high number of sanctions, and not only has competency on data protection but also on infringements of the E-commerce Act and the Telecommunications Act that affect digital CRM.

Taking the above into consideration, the risk of sanctions in Spain due to non-compliance with the applicable requirements is very high.

Russia

Legislative Developments

Recently, the Russian parliament passed amendments to the laws "On Personal Data" and "On Information, Information Technology and Data Protection".

The amendments require any company that collects information about Russian citizens online to store that information on servers in Russia. They are to come into force on 1 September 2016, in order to give companies time to set up storage facilities in Russia. Non-compliant web resources may be blocked for Russian users.

While the proposed rules require companies to process personal data of Russian citizens "with the use" of Russia-located databases, by their language they impose no other major restrictions. Specifically:

i. operators are not explicitly required to perform data processing operations solely with the use of Russia-located databases;
ii. cross-border transmission of personal data of Russian citizens is not additionally restricted as compared to the already effective rules; and
iii. companies are not required to have the relevant Russia-located servers with the personal databases in their ownership.

The proposed rules provide for the creation of a Register of Personal Data Owners' Rights Infringers. Companies violating the Russia-located database requirement will be included in the register, based on a relevant court ruling. The Russian communications authorities will be entitled to block access to websites of the infringers listed in the register.

A company may be excluded from the register, and the relevant resource unblocked, if the underlying court ruling is reverted or if the company demonstrates that it has discontinued the violation.

The main challenge regarding data protection compliance in Russia is the high enforcement activity of regulators, and recent political and legislative trends.

Should the amendments to the laws "On Personal Data" and "On Information, Information Technology and Data Protection" be adopted, and all companies that collect information about Russian citizens online be obliged to store that information on servers in Russia, businesses may face substantial financial and technical hardships, even though the law is intended to have a transition period before 1 September 2016.

2. North America

The U.S.

As mentioned above in section C, the key issues for regulators are big data and data brokers and how these affect consumer privacy and other rights.

There is a push toward passing legislation to govern data brokers but this is still at the policy discussion phase.

The privacy compliance environment in the U.S. is very complex and sophisticated. Companies must keep informed on dozens of laws that may apply to any one initiative.

Especially in the online world, it is difficult to avoid the application of the laws of all 50 states in some cases.

Companies operating online should remain aware of these issues, and consider privacy early on, to ensure that any legal compliance issues are appropriately addressed as part of a successful digital CRM initiative.

3. Latin America

Brazil

Internet Legal Framework

The greatest impact should come from the Internet Legal Framework, which came into force in June 2014.

In addition to the liability for user-generated content and network neutrality, this law expressly provides for privacy and data protection (including retention of logs) rules.

Accordingly, the Internet Legal Framework contains several provisions regarding internet users' right to privacy, and dedicates a whole chapter to the protection of logs, personal data and private communications. On many occasions, the Internet Legal Framework emphasizes users' right to inviolability of his or her intimacy and private life (the violation of which may give rise to material damages and damages for pain and suffering) and inviolability and confidentiality of communications flow (except for disclosures pursuant to a court order).

Furthermore, according to this law, any collection, use, storage or processing of personal data requires the data subject's express consent. Under the law, such consent for the collection, use, storage and processing of personal data and such consent shall "stand out" from other contractual conditions. There is no clear guidance, judicial or legislative, as to how such consent should "stand out"; however, the purpose of this requirement is that consent should not be "hidden" amongst a website's terms of use, such that a "normal" user would not be able to easily identify it.

On this particular point, please note that, according to the Internet Legal Framework, personal data may only be transferred to third parties upon the free, express and informed consent of the data subject. Furthermore, information stored by websites and the contents of private communications may only be disclosed upon a relevant court order.

The Internet Legal Framework sets forth the mandatory application of Brazilian laws for the collection, storage and processing of personal data or communications if:

i. at least one of such actions takes place in Brazil; or
ii. at least one of the endpoints is located in Brazil.

This rule shall equally apply to foreign companies:

i. to the extent there is a Brazilian entity of the corporate group in Brazil; or
ii. their services are offered to the Brazilian public.

The main goal of such provisions is to prevent Brazilian entities of multinational groups arguing that data is stored in servers abroad, subject to foreign laws and, accordingly, that Brazilian laws should not apply to authority requests for the supply of user identification information, removal of user-generated content, or the like.

In the event of failure to comply with the rules above, the Internet Legal Framework determines sanctions of:

i. warnings;
ii. fines in the amount of up to 10 percent of the economic group's revenues in Brazil in the last year;
iii. temporary suspension of data collection activities; or
iv. prohibition of data collection activities.

Furthermore, the law expressly determines that the Brazilian entity of a group shall be jointly liable with the foreign entity for any fines imposed on the foreign entity for failure to comply with these data protection requirements.

Finally, according to the Internet Legal Framework, personal data may only be used for purposes that:

i. justify the collection thereof;
ii. are not prohibited under Brazilian laws; and
iii. are specified in the website's terms of use.

So far, the main challenge in remaining compliant with privacy rules has been the lack of specific laws and guidelines.

Despite the general provisions of the Brazilian Constitution, Civil Code and, in a more specific manner, the provisions of the CDC and the Internet Legal Framework, players still do not have specific standards to abide by in regard to privacy/data protection (e.g., definition of personal data, sensitive personal data, treatment of data, among other terms, as well as provisions regarding security measures, cross-border data transfer, and the creation of an official data protection authority with powers to impose sanctions, and cancel or block the processing or transfer of personal data, including specific sanctions for any compliance thereof).

In that sense, although the Internet Legal Framework represents a great contribution, its actual effects are yet to be seen by the relevant authorities and the public.

Mexico

An organization's reputation and future are greatly dependent on the success of CRM implementation. A failure in the introduction of CRM systems, particularly in service, sales and call centers, can result in disaster. Direct marketing is one of the major current and future concerns, along with anti-spam regulations and monitoring activities.

Taking into account monitoring activities, as a general rule, organizations are required to inform employees and/or consumers that monitoring activities can occur. In certain circumstances, consent can also be required.

When implementing surveys by email, phone or text, organizations should consider the spam laws in Mexico, the differences between transactional and marketing communications, responsibility for spam compliance, necessary disclosures, rules for obtaining consent, implementation of unsubscribe options and, importantly, the application of laws to outsourced marketing.

Regarding business-to-business (B2B) versus business-to-consumer (B2C) communications, please note that organizations should consider not only privacy laws but consumer protection rules, and their particular application to each type of communication. Organizations should also consider registration requirements for do-not-call lists and obtaining consent rules, among other things.

The main risks of non-compliance are unexpected data security breaches. Organizations that are involved in a data breach situation are required to comply with data breach notification requirements, such as notifying data subjects that were affected, depending on the scope of the breach; gathering information about the breach; assessing the potential risk of harm to the data subjects; taking steps to mitigate the harm; deterring the breach; preventing future similar breaches; and complying with the data authority and court orders.

Depending on the nature and scope of the breach, the organization may not be required to notify the national privacy authority. An organization that is involved in a data-breach situation may be subject to an administrative fines and penalties, or civil actions and/or class actions.

In addition, the FCPL contains fines for non-compliance. In the case of backsliding, fines may be doubled and imprisonment penalties can even be triggered.

4. The Asia Pacific

Australia

Given the funding environment applicable to the Privacy Commissioner, it is likely that particular industries and companies will be singled out for regulatory attention, especially heavily consumer-focused organizations.

There remains the potential for mandatory data breach notification legislation to be introduced. Several proposals have been put forward but, to date, no such legislation has been enacted. However, OAIC has issued voluntary data breach notification guidelines.[73] OAIC has made it clear that direct marketing will be an area of focus for it.

In March 2014, the Australian Law Reform Commission (ALRC) released a Discussion Paper on Serious Invasions of Privacy in The Digital Area. This discussion paper includes the proposal for a new statutory cause of action (a tort) for the "serious" invasion of privacy. The test of "seriousness" would be an objective test, which the courts could measure by asking whether the invasion of privacy was likely to have a serious effect on a person of ordinary sensibilities in the position of the plaintiff.

The Australian Attorney-General has been reported as saying that the federal government does not support the creation of such a tort.[74]

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[73] See http://www.oaic.gov.au/privacy/privacy-resources/privacy-guides/data-breach-notification-a-guide-to-handling-personal-information-security-breaches.

[74] Please see at http://www.theaustralian.com.au/business/legal-affairs/brandis-rejects-privacy-tort-call/story-e6frg97x-1226873913819?nk=4140760ae0d8dcfeeb0ae16fa583521c.

In the event that a tort of privacy is not introduced, ALRC proposes that legislation be introduced to allow for the recovery of damages for emotional distress in actions for breach of confidence for serious invasions of privacy.

ALRC has also recommended the introduction of a new APP, essentially a "right to be forgotten", which would:[75]

i. require an entity to provide a simple mechanism for an individual to request destruction or de-identification of personal information that was provided to the entity by the individual; and
ii. require an entity to take reasonable steps, in a reasonable time, to comply with such a request, subject to suitable exceptions, or provide the individual with reasons for its non-compliance.

Challenges to compliance include the following:

i. the use of third parties to perform tasks and functions on an entity's behalf, particularly where the third party is offshore, and the entity remains liable for the third party's act and practices. This can be particularly challenging where the entity relinquishes control of personal information, either fully or in part;
ii. maintenance of effective data security (particularly where personal information is stored offsite, offshore or with a third party). The challenge for an entity is to ensure that effective security mechanisms are in place. This can include physical and IT security, personnel security and training; governance, policies and standards; and regular monitoring and review;
iii. the control of personal information in compliance with the Privacy Act and APPs. The loss of such control can be due to external and internal persons. While contractual data security provisions are helpful in meeting this challenge, organizations should also consider de-identifying personal information, and limiting access to those personnel and/or service provider personnel who require access in order to perform the functions for which the personal information was collected; and
iv. ensuring compliance with direct marketing requirements under the APPs, the Spam Act and Do Not Call Register Act. Where an entity uses a third party provider to undertake direct marketing on its behalf, any such marketing should also meet these specifications.

China

The amended PRC Consumer Protection Law, which came into effect recently, imposes data protection obligations on all business operators that provide goods or services to consumers in China, including business operators whose headquarters are based overseas and/or sell their goods or services via the internet, TV, telephone or mail order to PRC consumers.

As pointed out above in section C, there is no specific legislation on personal data protection or privacy in China but the concept of privacy or data protection exists under various pieces of laws and regulations.

These laws and regulations, however, are not necessarily consistent with each other. Further, the provisions on data protection/privacy are generally ambiguous and broad in scope, with the

[75] The full report can be found via the following link: http://www.alrc.gov.au/publications/serious-invasions-privacy-dp-80.

relevant local authorities having quite substantial discretion in interpreting and enforcing those laws and regulations.

Hong Kong

As mentioned above in section C, the prohibition on transfer of personal data outside Hong Kong is not yet in force.

However, the Privacy Commissioner has recently completed a survey of 50 jurisdictions and, as we understand it, come up with a white list of places that have in force a data protection law that is substantially similar to, or serves the same purpose as, the PDPO.

A copy of the report has been forwarded to the government but as yet there is no other indication as to when the provision will come into force. However, as a matter of best practice, we recommend that brand owners, where possible, obtain consent from data subjects for cross-border transfer if cross-border transfer is anticipated.

The Privacy Commissioner has called for a shift from compliance to accountability in organizational privacy management, and urged that data users should go further than ensuring compliance with mandatory legal obligations under the PDPO, but also manage, handle and be accountable for customer personal data, in accordance with good corporate governance principles.

The Privacy Commissioner promotes the maintenance of a comprehensive privacy management program and indicates this is conducive to a relationship of trust with regulators and customers.

The direct marketing regime under the PDPO imposes additional notification and consent requirements on data users who wish to use and/or transfer personal data for direct marketing purposes. The requirements of the law are specific, and are burdensome compared with those of other jurisdictions in the region. Non-compliance carries the risk of fines and imprisonment (please see section I.5 c) for further details).

Japan

In Japan, it appears unlikely there will be amendments of the Act or issuance of new laws that may have material impact on digital CRM, at least in the near future. Considering the current legislative framework, the following issues are worth mentioning.

One of the hot topics is big data and usage of the so-called "life log" in big data.

In principle, if the information to be used is appropriately anonymized, the information will not be the "personal information" defined in the Act and therefore the regulation under the Act will not be applicable. However, whether or not the information is appropriately anonymized is not clear sometimes. This issue is under ongoing discussion by government and industry.

Also, information security incidents happen quite often and they always lead to at least reputational damage.

As mentioned above, trends regarding compliance issues in relation to big data need to be monitored.

The risk in Japan of sanctions for non-compliance with the Act is not as heavy as that in certain other countries/jurisdictions, such as EU countries. However, the risk of non-compliance may have a material impact from a reputational perspective.

Singapore

In view of the high penalties and the statutory right of private action, the risks of non-compliance would appear to be reasonably high.

It should be mentioned that the PDPC has not initiated any *suo moto* action so far and all investigations have originated from consumer complaints. Hence, unlike some other countries where the regulators have taken an aggressive stance vis-à-vis personal data protection, it is not the case so far in Singapore. Having said that, it is be important to closely monitor how the enforcement landscape shapes up in Singapore in the coming years.

As the PDPA is a new law, organizations should review their privacy policies and procedures, as well as their marketing guidelines, and update them for compliance with the PDPA as well as the SCA. In addition, organizations should maintain records to show compliance in the event there is an investigation by PDPC. In particular, records of consent from consumers should be maintained in a retrievable form and reliance on deemed or implied consent is discouraged.

Taiwan

The PDPA that came into effect on 1 October 2012 imposes a heavy compliance burden on all, including the digital dimension. So far, there are no data protection laws or regulations specifically enacted to regulate the digital dimension.

Given the PDPA's general application to the digital dimension and the physical world, it is important to monitor the overall development of its enforcement because it can impact the digital dimension as well. As digital/online activities are growing, it is likely that specific regulations will be developed to regulate the digital dimension.

In particular, the amendment to article 54 of the PDPA is worth monitoring.

In respect of personal data collected from a source other than the data subject prior to 1 October 2012, article 54 of the PDPA provides for a requirement to inform the data subject within one year from its effective date. However, this provision has never come into force and is currently being amended by the legislators because it would create unbearable costs for some industries.

It is expected that the amendment will relax the original requirement, but it will still impose additional obligations, including on the digital dimension.

One of the biggest challenges in remaining compliant with the PDPA is the maintenance and improvement of security measures, which is particularly crucial for the digital dimension.

This includes control of data flow and supervision of third-party service providers, which are more challenging for the digital dimension. Given the nature of digital data, the risk of non-compliance in this regard is higher than with physical data.

Another challenge is to duly inform the data subjects. With the amendment to article 54 of the PDPA pending, it is expected that the risk of non-compliance in this regard will be lowered compared with the original requirement under article 54 of the PDPA.

IV. 'Phygital' Strategy by Design

A. Why Compliance Does Matter

It is a well-acknowledged fact that the online and digital dimension is a remarkable tool available to fashion and luxury brands to increase revenue, to better engage with customers, to create loyalty and brand awareness, and to foster and enhance the concept of brand experience and CRM.

However, as stated at the beginning of this chapter, the virtual ecosystem presents risks, since, if not well managed, it may backfire. It should also be underlined that the negative consequences in this context are increased by the same technology tools that allow users to immediately reach out to a potentially unlimited audience of customers. Indeed, the echo of a breach of customers' privacy may be much more detrimental when reported by online blogs, social networks platforms, etc.

The reasons to comply with the applicable legislative framework may be summarized as follows:

- fines and exposure for damages are significant in terms of costs;
- criminal sanctions may be applied;
- the risk of reputational damage, which is probably the key risk, together with loss of customers' trust;
- the risk of audits and investigation by data protection and other competent authorities is material; and
- the risk of loss of business opportunities: e.g., in the case of a block of infringing databases.

B. The Value of the Holistic Approach and the "Privacy Mantras"

A phygital strategy should be conceived and built by design, meaning that it should be organized according to the specific needs and features of a brand, especially the heritage values that are to be conveyed to customers.

In addition, the digital and online strategy of a brand should encompass the brand experience offered to a customer in the virtual as well as the real environment, so capturing at 360 degrees the multichannel and multifaceted relationship with the customer.

In this sense, a holistic approach seems the best avenue to choose, meaning that a brand should set up its communication and engagement environment considering all possible exposure of the customer to the brand's values and heritage.

Another key factor is the accurate selection of internal functions called to team up. As highlighted above, the digital dimension should not be regarded as an issue to be dealt with only by online marketing and digital people. It should be discussed and designed with the input of different players: e.g., store and retail persons, IT managers, "traditional" marketing persons, and, of course, the intervention of the legal department is needed in order to understand the limitations imposed by the law and to make reasonable choices in managing risks.

The message is that designing a privacy compliance program to effectively manage risk globally is feasible if this issue is dealt with seriously, in an organized and structured manner.

In this context, there are some "privacy mantras" that should always be taken into account as general guidance, and then be tailored according to factual circumstances and case-by-case considerations. These privacy mantras may be summarized as follows:

- define the work perimeter: have it clear in your mind what the intended achievements are;
- always plan in advance, trying to avoid engaging in last-minute initiatives;
- be transparent and always tell the truth to customers;
- make use of simple and effective wording, avoiding legal jargon;
- accept the fact that you need the customer's consent;
- verify customer privacy documentation and put in place sound procedures to manage this;
- carefully consider how you protect customer data;
- set a timeline for customer data retention;
- carefully consider the issues to do with third-party service providers;
- map and regulate data transfers, especially trans-border data flows;
- collect and keep only the customer information that is really necessary;
- always keep an holistic and forward-thinking approach; and
- constantly monitor, review and update your compliance program, especially in relation to changes in the law, in technology, in business needs and market trends.

Chapter 4: Social Media

I. Introduction

Social networks, viral marketing, crowdsourcing, open-sourcing, the economies of sharing, and other modern phenomena, have changed the way we connect, work and do business. These changes bring opportunities and risks. Therefore, companies in the luxury and fashion industry have to position themselves appropriately, and develop training and rules for their employees. This chapter summarizes the key legal considerations and gives practical recommendations in checklist form.

The terms “social networks” and “social media” refer to communities that connect and interact over online technology platforms. Individual members present themselves on personal profiles with information about themselves, create relationships with other members, and communicate bilaterally or collectively. Social media platforms tend to have a particular purpose that members share. Users of LinkedIn, for example, are focused on professional or business connections and, consequently, present their educational backgrounds and career development to connect with others for business purposes. Individuals who want to maintain or form personal connections meet on Facebook. On Yelp, consumers recommend good – and warn about bad – e.g., restaurants, dentists and contractors. This has led to a game change particularly for small businesses and professionals in large cities, which can better compete based on quality of service, and business reputation extending beyond small, local communities. Groupon helps consumers find good local deals; airbnb assists with renting houses, cars or boats to other users; TripAdvisor with travel planning; and OpenTable with assessing and booking restaurants. User reviews on shopping comparison and e-commerce sites such as Nextag and Amazon have taken consumer reviews to a new level. Community-driven Wikipedia has become the go-to place for knowledge regarding just about everything, supplemented by various topical sites (including BabyCenter for information exchange about raising children). Follow-up questions can be asked on Pearl.com (previously known as JustAnswer).

Social media users can choose between a wide and ever-expanding variety of new and innovative communication channels to share and exchange information bilaterally or collectively. They can send emails and text messages to individual recipients whom they select; communicate “live” via chat, instant messaging and internet telephony; tweet to followers who choose them; write on more or less public discussion forums, bulletin boards and individuals’ profile pages; or broadcast information on their own pages for the world to see via search engines, or for individually managed lists of friends or contacts. On Twitter, users can access a “real-time information network” that connects them “to the latest stories, ideas, opinions and news about what they find interesting”[1], i.e., personal and commercial communication. For more business-focused networking, companies and individual employees can sign up with Yammer, and broadcast to coworkers or contacts with a common business interest. Citrix Online and other

[1] See twitter.com (accessed 1 October 2013).

companies offer online tools to share documents and meet in spontaneous web or video conferences.

Social media platforms have experienced rapid growth in users who communicate for personal and business purposes. Companies are wondering if and how they should utilize social media for company-internal communication, marketing, research, recruitment and other business functions; whether they should support existing platforms or create their own; and how they should regulate usage and communications between their employees and with customers, suppliers, job candidates and others.

Via social media platforms, employees can exchange information quickly, create initiatives and communities that share interests and work on projects without meeting in person, schedule phone calls or write up formal letters or emails. On social media forums, employees can present experiences and ideas to solve problems for discussion outside the schedule of day-to-day business processes and clearly assigned roles. Equally, employers can take in opinions and ideas from interested groups in the extended enterprise that may otherwise not be heard. New colleagues can integrate themselves better with a contribution to an ongoing discussion and find more quickly a sweet spot for their talents. Younger employees find the new communication forms more intuitive and can flourish in workplaces that endorse sharing of information via social media. Innovative start-up companies can benefit immensely from marketing techniques on social media platforms, because they can spread news and ideas more quickly and on limited budgets. Consumer discussion forums tend to present balanced information on user experiences that supplements the manufacturer's own promotional materials, specifications and disclosures. If a new product is discussed controversially on a forum and ultimately does well, social media users tend to accept the information as more meaningful than information that the producer or service providers pushes unilaterally. They can spread the news via viral campaigns, and instantly create a reputation for a product that would otherwise have had to wait months or years for tests by traditional consumer associations or media outlets.

All these opportunities come with a number of risks. Within a company, overly active and frank discussions can lead to chaos, distraction and management challenges. Productivity may suffer. Pursuant to a survey by the *Ponemon Institute* in 12 countries of more than 4,500 professionals in the IT sector, 89 percent of respondents noted a decrease in productivity resulting from an increased use of social media at the workplace.[2] Also, lawyers can easily imagine horror scenarios where employees use social media to bully or harass coworkers, share illegal content, copy files without copyright licenses and invade others' privacy.

Externally, there is a concern that the ease of information sharing can lead to inadvertent or malicious disclosures of trade secrets, publication of misleading or incorrect information about a company or its products, and viral marketing campaigns that ultimately backfire. In the areas of politics and justice, we can already see highly publicized missteps: in the United States and United Kingdom, jurors have been removed and sanctions imposed for tweeting contrary to jury instructions[3] or conducting online research on Facebook in contempt of court rules.[4] New York

[2] *Ponemon*, Global Survey on Social Media Risk: Survey of IT & IT Security Practitioners, BNA Privacy & Security Law Report, 10 PVLR 1471.
[3] *Dimas-Martinez v. State,* Ark., No. CR 11-5; http://pub.bna.com/cl/115.pdf (accessed 16 December 2011); BNA Privacy & Security Law *Report*, 10 PVLR 1870; A.B. 141, http://www.leginfo.ca.gov/pub/11-12/bill/asm/ab_0101-

senator Anthony Weiner made headlines and midnight talk show entertainment by inadvertently broadcasting nude photos that were meant for individual followers.[5]

Like politicians and celebrities, companies can use social media for marketing purposes; they also have to brace themselves for the possibility that their own representatives' social media experiments result in the same kinds of embarrassment that politicians and celebrities have experienced.[6] Additionally, concerns regarding data security and data mining remain on the radar.[7] Charge-free social media platforms usually derive revenue from collecting, mining and sharing information for marketing purposes in cooperation with more or less known third parties.[8] If companies allow employees to use such platforms for business purposes, they have to develop rules to avoid raising doubt regarding the reasonableness of their trade secret protection measures, attorney–client privilege, data security compliance, stock exchange rules on selective disclosures and regulatory compliance obligations. Also, we are reminded daily that social networks are abused through various criminal activities, including phishing.[9]

All this can raise the question whether social media requires fundamentally new regulations or exemptions from existing laws. When the internet became popular, commentators were quick to demand new laws[10] or declare the independence of cyberspace.[11] Similar claims surfaced when virtual worlds arrived on the radar of public opinion.[12] New technologies often make politicians wonder whether fundamental regulatory or statutory gaps exist. Upon closer review, however, this is relatively rarely the case.[13] Instead, existing rules can be and are in fact continuously applied to

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0150/ab_141_bill_20110805_chaptered.pdf; (accessed 16 December 2011); BNA Privacy & Security Law Report, 10 PVLR 1250.

[4] www.guardian.co.uk/law/2012/jan/23/juror-contempt-court-online-research (accessed 3 March 2012).

[5] *Barrett*, Democrats Push Weiner to Go, *Wall Street Journal*, 9 June 2011, see: http://online.wsj.com/article/SB10001424052702304392704576374014222200024.html (accessed 16 December 2011).

[6] Cf. *Odorn*, Experts Advise Corporate Audit Committees To Focus on Addressing Social Media Risks, BNA Privacy & Security Law *Report*, 10 PVLR 1370.

[7] See, *Campbell v. Facebook Inc.,* W.D. Ark., No. 5:11-cv-05266-JLH; BNA Privacy & Security Law Report, 10 PVLR 1832; *Alexis*, Lawmakers, Groups Asks FTC to Investigate Alleged Facebook Tracking of Offline Users, BNA Privacy & Security Law Report, 10 PVLR 1448.

[8] See, *Soble v. Google Inc*., D. Del., No. 1:12-cv-00200-UNA, complaint filed 2/17/12; *Michaels v. Google Inc*., E.D. Tex., No. 6:11-cv-00107-LED, complaint filed 3/8/11; *Low v. LinkedIn Corp.,* N.D. Cal., No. 11-CV-01468-LHK; BNA Privacy & Security Law Report, 10 PVLR 1681; *Deacon v. Pandora Media Inc.,* N.D. Cal., No. 11-4674; BNA Privacy & Security Law Report, 10 PVLR 1463; *In re Facebook Privacy Litig.,* N.D. Cal., No. 5:10-cv-02389-JW; BNA Privacy & Security Law Report, 10 PVLR 1735.

[9] Cf. *Johnson*, Social Networking Sites Are 'Phishing Ponds' Malaysia Warns, Guidance Urges Safeguards, BNA Privacy & Security Law Report, 10 PVLR 1342.

[10] Cf. Lothar Determann, The New German Internet Law, 22 *Hastings International and Comparative Law Review* 113, 116 (1998); Ari Staiman, Shielding Internet Users from Undesirable Content, 20 *Fordham Int'l L.J.* 866, 866 (1997) (citing a European Commission Green Paper, which said, "We know that national regulation … is not enough, that European regulation is not enough … We may need to have a world regulation of these matters."

[11] https://projects.eff.org/~barlow/Declaration-Final.html (accessed 18 February 2012).

[12] Lawrence J. Speer, French Internet Rights Forum Proposes New Legal Rules for Online Games, 12 ECLR 1189 (2007).

[13] Recall how, in 2004, the California senate was quick to pass a new law to restrict the placement of ads into emails when a charge-free email service with targeted ads based on automated analysis technology was launched (http://news.cnet.com/California-Senate-approves-anti-Gmail-bill/2100-1028_3-5222062.html), only to withdraw the bill a few weeks later when realizing that existing California law was strict enough – and probably even stricter than the proposed new statute (see Calif. Bill to Bar E-Mail Scans Withdrawn; Paper Records Privacy Amendment Dies, 3 PVLR 954); seven years later, the pre-2004 laws are invoked in a class action lawsuit that appears absurdly outdated (www.informationweek.com/news/smb/hardware_software/228300269: Eric Goldman characterizes the complaint as an "are-you-kidding-me? lawsuit" on his blog. "Frankly, after all the furor died down a half-decade ago, I had assumed everyone had moved on long ago.").

new technological, economic and social developments, supplemented and adapted from time to time.[14] The same is true with respect to workplace regulation of social media: fundamentally, new rules are rarely required, but companies have to consider how to apply and adapt existing rules to the new social media platforms and usage.[15]

II. Selection of Social Media Platforms for Businesses

In many cases, employees select social media platforms for business use for the same reasons they choose such platforms for private use: namely, because friends invite them, a critical mass of users exists, interesting content exists and the functionality is attractive. Some companies add strategic considerations to the decision-making process and proclaim it as a company objective: e.g., that they want employees to use social media platforms instead of email for company internal communications.[16] Where companies allow or instruct employees to use certain social medial platforms for communications with coworkers, customers or other business partners, companies have to consider requirements under industry-specific regulations, data privacy laws and corporate contracts. As a result, they may integrate routine vendor due diligence steps in the selection process and determine whether the social media platform provider makes sufficient confidentiality commitments in the terms of use and satisfies "adequacy" requirements under European data protection laws.[17] If a company finds that established social media platforms do not meet its requirements, it can try to start up its own platform (developed in-house or by a service provider under contract). Such company-operated social media platforms can serve some company internal communication needs better, but will often lack the prospects for sufficient critical mass to be successful with customers, vendors and other external parties. Also, employees may be slower to adopt a new platform that they are not already used to, which can jeopardize the company-operated platform's chances of success. For these reasons, many companies pursue both avenues, and embrace major publicly available social platforms for external communications and, at the same time, establish company-operated platforms for confidential, internal communications.

III. Scope of Workplace Rules for the Use of Social Media

As companies apply and adapt workplace rules for the use of social media, they have to draw a line between usage that concerns their business and purely private use that they cannot or do not want to regulate. They need to find a business nexus deriving from a number of different parameters of social media usage:

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[14] Cf. *Russel*, Employment/Labor Law Meets Social Media: Advice for Employers, BNA Privacy & Security Law Report, 10 PVLR 1166; *Klickermann*, MMR 2007, 766; see also Lothar Determann, Freedom of Communications on the Internet (1999).

[15] See, e.g., Joyce E. Cutler, Social Media Present Old Discovery, Workplace Policy Challenges in New Box, 10 PVLR 657.

[16] See French Company Atos Bans Email – A Better Way to Communicate, see http://news.yahoo.com/french-company-atos-bans-email-000300431.html (accessed 1 October 2013).

[17] Lothar Determann, International Data Transfers from Europe and Beyond (25 Rev Bank Finance Serv – 2009); Lothar Determann, EU Standard Contractual Clauses for Transfers Of Personal Data to Processing Service Providers Reassessed, BNA Privacy and Security Law Report (2011), 10 PVLR 498; Lothar Determann and Jesse Hwang, Data Security Requirements Evolve: From Reasonableness to Specifics, 26 *Computer & Internet Lawyer Issue* 9, p. 6 (2009).

i. purpose of usage (work-related/private);
ii. ownership of the equipment used (company-owned/private);
iii. ownership of the social media platform (company-owned/third party-owned);
iv. time of usage (within/outside work hours); and
v. place of usage (on company premises/elsewhere).

Companies should consider addressing the use of social media by their employees if there is a business connection with respect to any one of these parameters. The following chart illustrates the nexus consideration with the [+] symbol and shows that many aspects of employee social media use – perhaps more than one would initially suspect – have a business nexus.

Strictly speaking, there should be no private purpose use during work hours, because, by definition, private purpose use of social media should not count toward working hours. Nevertheless, the chart acknowledges with a [+] the fact that private and business purposes for social media usage, as well as working hours and private time, have become nearly indistinguishable for most employees. (Of course, this raises its own concerns, given rules on overtime and maximum working hours in many jurisdictions.) The Volkswagen group has recently announced that, going forward, it will deliver emails outside regular working hours only to managerial employees.[18] However, employers can hardly regulate the use of LinkedIn, Facebook, Twitter, Yelp and Yammer for times of use.

			1	2	3	4	5	6	7	8	9	10
			purpose of usage		ownership of equipment used		ownership of social media platform		time of usage		place of usage	
			work-related	private	company-owned	private	company-owned	third party-owned	within working hours	outside working hours	on company premises	elsewhere
1	purpose of usage	work-related			+	+	+	+	+	+	+	+
2		private			+		+		+		+	
3	ownership of equipment used	company-owned	+	+			+	+	+	+	+	+
4		private	+				+		+		+	
5	ownership of social media platform	company-owned	+	+	+	+			+	+	+	+
6		third party-owned	+		+				+		+	
7	working hours	within working hours	+	+	+	+	+	+			+	+
8		outside working hours	+		+		+				+	
9	place of usage	on company premises	+	+	+	+	+	+	+	+		
10		elsewhere	+		+		+		+			

Independent of social media phenomena, companies need to regulate employees' use of company-owned devices and communication systems for personal purposes. Such rules are relevant and applicable to social media activities as well, and set the stage for the permissible reach of monitoring of employees by their employer. In this regard, companies may have to differentiate between devices that the company buys and makes available to employees, devices that employees buy and receive full or partial reimbursement for, and devices that employees buy with their own funds but use for work or to connect to company systems. More and more

[18] See www.bbc.co.uk/news/technology-16314901 (accessed 18 February 2012).

employees bring their own devices to work and use them there.[19] Some employers allow emails to be delivered to employee-owned smartphones and pay for data plans, whereas the employee remains responsible for paying for voice and text message plans. Under such circumstances, employers often regulate and monitor email usage in detail, but apply only general rules of conduct to voices calls and text messages and do not attempt to monitor these. With respect to social media platforms, employers have to adapt their monitoring protocols and let employees know where they can and cannot expect privacy.[20]

IV. Topics to Consider for Social Media Policies – A Checklist

When companies create rules for social media usage, they should distinguish between the group of addressees and issue, first, one brief protocol with general rules that apply to all employees; and, second, specific protocols for particular groups of employees, e.g., information technology (IT) staff and human resources (HR) managers. If companies combine such general and specific protocols, and perhaps also add some explanations and policy statements on top of this, the resulting documents become unfocused, confusing and even longer than they have to be. As a result, employees cannot be expected to read and follow such policies.

Whether social media rules are best issued on a stand-alone basis or integrated into related protocols (e.g., on computer usage, processing of personal data and monitoring) depends on a company's focus and the level of sophistication of its employee population. As usual, there are hardly any general best practices for all companies. Best practice is whatever works best for a particular company.

A. General Rules for All Employees

1. Threshold Question – Prescribe, Prohibit or Permit?

What particular rules companies issue on specific points depends on the threshold question of whether the company wants employees to use social media (because the company perceives opportunities), wants to restrict the use of social media as much as possible (because the company sees more risks than benefits), or is somewhat ambivalent and wants to permit social media use to the degree necessary to maintain good employee morale. Either way, the company should clearly communicate its position in writing, to prevent the development of implied permissions or entitlements and to ensure that employees understand expectations.[21] Without written guidance, employees will typically assume that social media usage at the workplace is acceptable.[22]

[19] Cf. *Aplin*, Growing "Bringing your own device" Trend Further Blurs Work, Personal Privacy Line, BNA Privacy & Security Law Report, 10 PVLR 1096.
[20] Lothar Determann and Robert Sprague, Intrusive Monitoring: Employee Privacy Expectations are Reasonable in Europe, Destroyed in the United States, 26 *Berkeley Technology Law Journal* 979 (2011).
[21] Cf. *Oberwetter*, NJW 2011, 417 (418); *Lützeler/Bissels*, ArbRAktuell 2011, 499.
[22] Cf. *Ponemon*, Global Survey on Social Media Risk: Survey of IT & IT Security Practitioners, BNA Privacy & Security Law Report, 10 PVLR 1471.

The U.S. Internal Revenue Service has completely outlawed the use of social networks on government-owned computers or at the workplace.[23] Studies claim that larger companies are taking a similar approach.[24] But many companies will not find it realistic or practical to completely prohibit social media use. Also, many see advantages and opportunities in social media that they do not want to miss out on, either for marketing and business development purposes or communication more generally.[25]

2. Details to Address

a. Personal Use During Working Hours

When employees use social media for personal purposes during regular working hours, the time spent does not count as hours worked. Companies do not have to specifically point this out in written notices; this should be generally understood.[26] This applies also to any personal use of systems or social media platforms that the employer provides, recommends or prescribes for professional use. In some cases, it can be difficult for employee and employer to determine when particular forms of communication are work related or purely personal, but such difficulties are hardly a new phenomenon. They also arise in connection with more traditional forms of communications among employees (e.g., hallway chats) and cause problems only when excessive personal communication affects productivity or morale.[27]

b. Monitoring

Employers need to disclose the extent to which automated, continuous monitoring or incident-related investigations extend to the use of company-owned equipment, personal equipment that connects to company systems or company-operated social media platforms.[28] Some forms of monitoring are necessary to protect data security, trade secrets, and compliance with laws and company policies, but employers have to respect limitations under data protection and communications laws.[29] For U.S. law purposes, employers should assess to what extent monitoring technologies and processes extend to social media usage, and update their disclosures in order to manage the development of privacy expectations in employees, which may require more specific and detailed disclosures on the reach of such technologies (e.g., via screenshot and

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[23] IRS Chief Counsel Notice (CC-2011-016) on Personal Computer-Use Policies, Social Media Websites at http://op.bna.com/pl.nsf/r?Open=dapn-8k8n4f. (accessed 16 December 2011); cited also at BNA Privacy & Security Law Report, 10 PVLR 1096.

[24] *Society for Human Resource Management*, http://op.bna.com/dlrcases.nsf/id/mroe-8ngv9d/$File/SHRM%20social%20media.pdf (last accessed 17 December 2011), also cited at BNA Privacy & Security Law Report, 10 PVLR 1680.

[25] See reports about companies moving consciously to social media for company-internal communications, e.g., French Company Atos Bans Email – A Better Way to Communicate, see http://news.yahoo.com/french-company-atos-bans-email-000300431.html (accessed 16 February 2012).

[26] But see *Russel*, Employment/Labor Law Meets Social Media: Advice for Employers, BNA Privacy & Security Law Report, 10 PVLR 1166.

[27] Cf. *Lützeler/Bissels*, ArbRAktuell 2011, 499.

[28] Lothar Determann and Lars Brauer, Employee Monitoring Technologies and Data Privacy –No One-Size-Fits-All Globally, 9 *The IAPP Privacy Advisor,* 1 (2009).

[29] See, *Determann/Sprague*, Intrusive Monitoring: Employment Privacy Expectations Are Reasonable in Europe, Destroyed in the United States, 26 *Berkeley Technology Law Journal*, 979 (2011).

key-stroke logging).[30] For employees abroad, employers need to assess what tools and protocols are permissible under local law, and consider reconfiguring tools, consulting with works councils, updating filings with data protection authorities and other steps that may be legally required.[31]

c. Prescribed Use of Social Networks

Companies that recommend or prescribe social media for company internal communications should consider limitations on data categories in employee profiles. Employees have more or less substantial privacy interests regarding particular data categories, which they may want to share among friends but keep out of the work sphere. German courts have found that public sector employees have to tolerate the publication of their name, function and work contact information on the internet, to the extent the individuals are involved in external communications on behalf of their employer.[32] It should generally be unproblematic to adopt these kinds of data categories into social media platforms even without employee consent. But employers should consider carefully whether it is in their interest to broadcast other types of information that frequently appear on personal profiles in social media, such as photos (possibly disclosing ethnicity, gender, disability, age, etc.), birthdates, relationship status and personal interests (which can reveal religious and political affiliations). Such information can haunt the employer in the context of discrimination claims. If employers allow such disclosures at all, they should at least post informative notices and make the data fields optional, to obtain informed consent from employees, which is required under the laws of many European jurisdictions.

d. Censoring Employee Profiles and Communications

Employers may find certain online profiles or presentations embarrassing or unnecessarily provocative. But companies face limitations regarding their influence on employee speech. In many jurisdictions, employers have to respect employees' rights to engage in concerted actions, which includes commenting on workplace conditions, albeit not in unnecessarily destructive or insulting forms.[33] In many jurisdictions, companies also have to allow employees to blow the whistle on illegal company practices.[34] Moreover, civil rights can apply directly or indirectly in the employment relationship.[35] As a rule of thumb, employers have relatively greater discretion with

[30] Lothar Determann and Robert Sprague, Arbeitnehmerüberwachung und Datenschutzerwartungen in den USA und in Europa: Es bleibt alles anders RDV 2011, 274.

[31] See *Determann's Field Guide to International Data Protection Law* (2012), par. 5.29.

[32] *BVerwG*, Beschluss v. 12.3.2008, 2 B 131/07, BeckRS 2008, 33735; *Oberwetter*, NJW 2011, 417 (418 f.).

[33] *JT's Porch Saloon & Eatery Ltd.,* NLRB Div. of Advice, No. 13-CA-46689; *Martin House,* NLRB Div. of Advice, No. 34-CA-12950; *Wal-Mart,* NLRB Div. of Advice, No. 17-CA-25030, BNA Privacy & Security Law Report, 10 PVLR 1117; DK (Horsens) Ct., No. BS 150-1946/2009, Privacy & Security Law Report, 10 PVLR 1310; *Largent v. Reed,* Pa. Ct. Com. Pl., No. 2009-1823; "[t]*here is no reasonable expectation of privacy in material posted on Facebook*." *Krudewagen & Stam*, Global Employee Terminations in the Age of Social Media, employmentlaw 360 of 26 August 2011 (http://www.law360.com/articles/267702/global-employee-terminations-in-the-age-of-social-media). In UPMC, No. 06-CA-081896 (N.L.R.B. A.L.J. Apr. 19, 2013), an administrative law judge found unlawful a prohibition on participating in social media networks, without the employer's consent, that: (1) describe any affiliation with the employer or (2) disparage or misrepresent the employer or (3) make false or misleading comments about the employer.

[34] European Court of Human Rights, NJW 2011, 3501 (Heinisch vs. Germany, Whistleblowing).

[35] For example, the California Constitution contains rights that are directly applicable between employer and employee, and German courts regularly refer to constitutional rights in employment decisions on the basis that the court is bound by the constitution when deciding on claims between private companies and individuals.

respect to employee communications on company-operated social media platforms. But where employees create profiles primarily, or also, for personal purposes, employers are largely reduced to requiring that employees protect confidential information, clarify that they are not speaking on behalf of their employer where they are not authorized to do so, and refrain from intentionally harming the employer's reputation or legitimate business interests.

e. Confidentiality and Data Security

Employees must protect trade secrets – on social media as much as elsewhere. With respect to social media, companies have found a greater risk that, through connections with company-internal and -external persons and informal communications modes, employees tend to disclose information more lightly.[36] Particularly with respect to social media platforms that are not operated by the employer, companies are concerned about their inability to control company-related information that is stored on networks and servers around the world. Such lack of control can also mean that companies are challenged to keep trade secret protection measures reasonable, comply with statutory or contractual data security duties, observe litigation hold obligations and safeguard that personal data remains current and accurate. If properly implemented, cloud-based solutions can help solve many control and security problems.[37] But if employees use public, advertising-funded social media and communication platforms that were never intended for confidential communications to process customer information, they may cause their employers to violate data security and confidentiality obligations in statutes and customer contracts. Companies need to clearly instruct employees in this respect, to manage risks and preserve customer trust.[38] Employees may, and perhaps should, use public platforms for non-confidential communications, but confidential information may have to be kept on dedicated, secure platforms. Additionally, public companies have to observe rules on ad hoc publicity and prevent employees from disclosing material facts relating to the company's business to select groups of recipients if such facts would need to be published more generally.[39]

f. Endorsements

Consumers increasingly rely on recommendations and reviews from friends and strangers on social media platforms to make purchasing decisions. Rating systems on Amazon, Yelp and other internet platforms have helped consumers and businesses that care about consumer experiences. User reviews have significantly reduced the ability of companies to place poor products or services with the help of clever advertising campaigns. This has largely improved the fairness of competition – so long as the user reviews themselves are not distorted or misleading.

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[36] See *Krasnow*, Getting It Right: Five Must-Have Provisions for Your Social Media Policy, BNA Privacy & Security Law Report, 10 PVLR 1163.

[37] See Lothar Determann, Data in the Cloud: A Dozen Myths and Facts, 28 *Computer & Internet Lawyer* 11,1 (2011); Lothar Determann and Jesse Hwang, Data Security Requirements Evolve: From Reasonableness to Specifics, 26 *Computer & Internet Lawyer*, 9, 6 (2009).

[38] However, employers must distinguish between protecting validly confidential information and restricting employees' rights to discuss working conditions on social media. In *Target Corp*., 359 N.L.R.B. No. 103 (29 April 2013), the National Labor Relations Board (NLRB) held that a social media policy that instructed employees not to disclose "non-public company information" violated section 7 of the National Labor Relations Act, because it was overly broad.

[39] *Krasnow*, Getting It Right: Five Must-Have Provisions for Your Social Media Policy, BNA Privacy & Security Law Report, 10 PVLR 1163.

Unfortunately, it is possible that employees review the products of their own employer or a competitor without disclosing ulterior motives. This can result in misinformation, misleading of consumers and distortion of competition.[40] Companies should therefore restrict their employees from commenting or reviewing the companies' own or competing products, unless they are publishing information on behalf of their employer and are clearly identified as such, subject to regular prior review processes that most companies have in place for publication of product manuals and advertisements.

g. Direct Marketing, Spam

Companies also need to instruct and train employees regarding the use of social media for direct marketing purposes. Companies have to obtain prior consent from recipients to send marketing messages under laws in European, and many other, countries. Even where prior consent is not required, companies have to offer easy opt-out mechanisms, respect unsubscribe requests and include various disclosures.[41] These requirements do not only apply to email but to various forms of direct communications via social media platforms.[42] But employees find it much more difficult, and at times impractical, to comply with applicable requirements under, e.g., anti-spam laws, because many social media platforms are not intended for marketing purposes and do not contemplate the inclusion of opt-out mechanisms or disclosures. Therefore, employers need to instruct and train their employees regarding compliance with laws, and also provide terms and conditions.

h. Termination of the Employment Relationship

Planning ahead is always a good thing, and companies need to establish clear rules regarding the treatment and ownership of social media profiles and accounts. Customer lists and contact information are usually owned by the employer. Parting employees have to leave customer lists behind, but are free to re-establish contacts when they arrive at a new job (possibly after expiration of non-compete periods). In the context of social networks, however, it can be difficult to separate employee-owned profiles and employer-owned customer lists. If an employee merely administers a social media account that is registered in the employer's name, the employer usually owns the account and all data therein.[43] But if the employee used a personal profile, registered in the employee's own name, the employer may find it more difficult to prove ownership, especially in light of possible restrictions in the social media operator's contract terms.[44] But the employer may

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[40] *Krasnow*, Getting It Right: Five Must-Have Provisions for Your Social Media Policy, BNA Privacy & Security Law Report, 10 PVLR 1163.

[41] Determann/Gates, Rethinking Compliance Strategies: After EU, U.S., Other Countries, Canada Passes Anti-Spam Law, 10 PVLR, BNA Data Privacy & Security Report, (March 2011); *Hung/Cartagena*, Social Media, Advertising and Marketing, Customer Relationship Management Databases and Online Privacy: Tips for Compliance With Canadian Law, BNA Privacy & Security Law Report, 10 PVLR 1108.

[42] See, e.g., *Facebook v. MaxBounty*, No. CV-10-4712-JF, 2011 WL 1120046 (N.D. Cal. 28 March 2011); *Facebook Inc. v. Power Ventures Inc.*, N.D. Cal., No. 5:08-cv-05780-JW, summary judgment granted 2/16/12.

[43] *Ernst*, NJOZ 2011, 953 (957).

[44] *PhoneDog LLC v. Kravitz,* N.D. Cal., No. C 11-03474 MEJ (settlement announced 3 December 2012); *Bivins*, Twitter Account, Followers May Be Protected As Trade Secrets, Property in California, BNA Privacy & Security Law Report, 10 PVLR 1682. In *Eagle v. Morgan, No. 2*:11-cv-04303-RB (E.D. Pa., 12 March 2013), an employer was found to have committed three privacy torts under Pennsylvania law when it took control of a former president's LinkedIn account.

be entitled to demand that the parting employee transfers customer data before termination.[45] If the employer fails to reach an agreement with the employee ahead of time, disputes may ensue that force courts to decide tricky questions regarding the relevance of circumstances such as whether the employee was allowed to use the account for customer data in the first place, whether the employee or employer paid for the membership and whether the employer requested or knew about the social media usage.[46] Where employees inherit employee accounts, e.g., on company-operated platforms, they have to decide how to deal with personal messages, data, texts and pictures.[47] To reduce the risk of such uncertainties, companies should reach detailed agreements with employees on ownership rights and transfer obligations relating to social media accounts in advance, within the limits established by applicable labor laws.

i. Court Proceedings

Companies should also make their employees aware of the fact that social media usage is relevant for court proceedings. Data stored on social media platforms may be subject to litigation hold and relevant for evidentiary purposes.[48] This may mean that the account holder may no longer delete or manipulate data that is related to proceedings, even if stored in an otherwise entirely personal account. Also, many jurisdictions place restrictions on communications with witnesses, defendants and jury members – via social media platforms or otherwise.[49]

j. Compliance with Laws

If a company decides to issue a separate social media policy, it should include a reminder that employees are also obligated to comply with laws and company policies in the social media context, including rules against harassment, distribution of obscene or illegal content, and defamation.

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[45] *Ernst*, NJOZ 2011, 953 (957).
[46] *Oberwetter*, NJW 2011, 417 (420).
[47] *Ernst*, NJOZ 2011, 953 (957); *Oberwetter*, NJW 2011, 417 (420).
[48] U.S. District Court for the Eastern District of Virginia, *In re App. of U.S. for Order Pursuant to 18 U.S.C. § 2703(d):* http://op.bna.com/pl.nsf/r?Open=kjon-8nmsyy (last accessed 16 December 2011); BNA Privacy & Security Law Report, 10 PVLR 1683; Pennsylvania Court of Common Pleas, Northumerberland County, *Zimmerman v. Weis Markets Inc.,* Pa. Ct. Com. Pl.: *http://pub.bna.com/eclr/09cv1535_051911.pdf* (last accessed 16 December 2011); BNA Privacy & Security Law Report, 10 PVLR 1060.
[49] See, e.g., *Dimas-Martinez v. State,* Ark., No. CR 11-5; http://pub.bna.com/cl/115.pdf (last accessed 12 December 2011); see BNA Privacy & Security Law Report, 10 PVLR 1870.

B. Specific Protocols for Particular Employees

1. Online Research on Job Candidates

Social media platforms are a rich source of information that companies are interested in for purposes of selecting job candidates.[50] As a rule of thumb, recruiters are advised to search only for information that they would also be allowed to ask the candidate directly.[51] Additionally, HR professionals should consider the following points.

If a candidate affirmatively consents to information access (e.g., by referring to a profile in application materials), the research is generally permissible.[52] The same should generally apply with respect to information that a candidate publicly posts or broadcasts without any restrictions, e.g., on a completely public profile.[53] More caution is advised when a profile is presented only to a limited circle on a social media platform.[54] Then HR professionals should consider only using data on social media platforms that are dedicated to professional purposes and not purely private posts (even if they may be able to access these also).[55] Under European data protection laws, companies may not be permitted to process data that third parties publish about a candidate without the candidate's consent,[56] regardless of whether such information is accurate and whether the candidate has claims against the third-party publisher.[57] Under European data protection laws, companies should also inform candidates about their online research practices[58] – a brief notice in the job ad should suffice. Secret data processing is generally not permissible under European data protection laws.[59] Actively concealed research methods (e.g., through anonymous accounts or "fake friends requests") constitute unfair business practices or misrepresentation under most jurisdictions' laws.[60]

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[50] See study of German Ministry of Consumer Protection, www.bmelv.de/cln_154/SharedDocs/Downloads/Verbraucherschutz/InternetnutzungVorauswahlPersonalentscheidungen.%20html (last accessed 8 December 2011; *Forst*, NZA 2010, 427 (428); *Oberwetter*, NJW 2011, 417 (417); *Bridgeford*, HR Practitioners Discuss Legal Limitations On Social Media Use to Vet Job Candidates, BNA Privacy & Security Law Report, 10 PVLR 1526.

[51] See *Bridgeford*, HR Practitioners Discuss Legal Limitations On Social Media Use to Vet Job Candidates, BNA Privacy & Security Law Report, 10 PVLR 1526.

[52] *Forst*, NZA 2010, 427 (430); *Lützeler/Bissels*, ArbRAktuell 2011, 499; *Ernst*, NJOZ 2011, 953 (955).

[53] *Forst*, NZA 2010, 427 (430); *Lützeler/Bissels*, ArbRAktuell 2011, 499; *Ernst*, NJOZ 2011, 953 (955); *Oberwetter*, NJW 2011, 417 (418).

[54] In 2012, Maryland was the first state to pass a bill prohibiting employers from requesting job applicants or employees to consent to employer access to restricted parts of private social media accounts (see S.B. 433 and H.B. 964). Many states have followed suit and, as of July 2013, 11 states have passed similar legislation. On the federal level, the Social Network Online Protection Act, H.R. 537, also addressing employer access to personal social media accounts, has been referred to committee.

[55] Vgl. *Forst*, NZA 2010, 427 (428); *Oberwetter*, NJW 2011, 417 (417); *Lützeler/Bissels*, ArbRAktuell 2011, 499.

[56] *Forst*, NZA 2010, 427 (432).

[57] But see *Forst*, NZA 2010, 427 (432).

[58] *Ernst*, NJOZ 2011, 953 (956); *Oberwetter*, NJW 2011, 417 (418); *Lützeler/Bissels*, ArbRAktuell 2011, 499.

[59] Cf. *Ernst*, NJOZ 2011, 953 (956); *Oberwetter*, NJW 2011, 417 (418).

[60] Cf. *Ernst*, NJOZ 2011, 953 (956). In *Trapp v. DHS,* Fed. Mediation & Conciliation Serv., No. 12-56290-A, a manager had heard that an employee had posted inappropriate content on Facebook. The manager created a fake Facebook account and successfully "friended" the employee. The manager was found to have violated the U.S. Stored Communications Act (SCA). In *Ehling v. Monmouth-Ocean Hospital Service Corp., No. 2*:11-CV-3305 (WMJ) (D.N.J. 20 August 2013), a nurse posted to her private Facebook account information about a work incident. A coworker, a Facebook friend of the nurse, took a screenshot of the post and showed it to hospital management. The court found that a private Facebook post was

Even where online research is generally legal, companies should carefully consider whether acquiring too much information is in their best interests. On social media platforms, companies can inadvertently find sensitive information that they would much rather not know, e.g., regarding candidates' gender, sexual orientation, ethnic background, disabilities, political opinions, union activities and religion.[61] To reduce the risk of discrimination claims based on such information, companies can task different employees with online research and candidate selection, and instruct the researchers to refrain from passing on information categories that cannot legally be used in the selection process and could support discrimination claims.[62] For similar reasons, larger businesses, in particular, should implement consistent rules and practices regarding the amount and methods of online research[63] and be careful to verify the accuracy of research results.[64]

2. Investigations

Social media profiles can reveal information about the personal circumstances of employees that companies may find very interesting for legitimate reasons. For example, an employee may post "going to doctor and then packing suitcase" and call in sick at work.[65] Another employee may constantly post text on a social media site while claiming that carpal tunnel syndrome prevents typing at work.[66] Supervisors who are connected to their reports via social media platforms may also see the real reasons for Monday absenteeism or note the frequency of personal posts during working hours. In the U.S., whether companies may collect and process such information for the purposes of investigations and employee monitoring depends on the scope of the companies' employee monitoring notices and the reasonableness of employee privacy expectations. In Europe, similar notice and consent requirements apply as with respect to online research on candidates. Also, courts will differentiate between the results of focused investigations and inadvertent findings.[67] For example, a company may inadvertently find evidence of employee misconduct on social media sites in the context of trademark-infringement monitoring activities. Companies may be able to use such information, whereas investigative research focused on a particular employee may require prior, specific notice.[68]

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protected under the SCA, but that there was no violation in this case because the coworker was an intended recipient of the post and had voluntarily showed it to the management.

[61] Cf. Vgl. *Oberwetter*, NJW 2011, 417 (418).

[62] See, *Bivins*, Employer Told to Split Social Site Review, Hiring to Avert Looming Discrimination Issues, BNA Privacy & Security Law Report, 10 PVLR 1155.

[63] Cf. *Larson*, EEOC Lawyer Cautions Use of Social Media Background Checks to Make Hiring Decisions, BNA Privacy & Security Law Report, 10 PVLR 1233.

[64] *Smith*, Too Much Worker, Application Personal Data, Too Little Understanding How to Handle It, BNA Privacy & Security Law Report, 10 PVLR 1591; also see *Krudewagen & Stam*, Global Recruitment and Social Media Hiring Traps, employmentlaw360 of 16 December 2011 (http://www.law360.com/articles/288802/global-recruitment-and-social-media-hiring-traps).

[65] *ArbG* Düsseldorf, Akz. 7 Ca 2591/11; *Lützeler/Bissels*, ArbRAktuell 2011, 499.

[66] Cf. *Lützeler/Bissels*, ArbRAktuell 2011, 499.

[67] See *Ernst*, NJOZ 2011, 953 (957).

[68] Cf. *Ernst*, NJOZ 2011, 953 (957).

3. Personnel Files and HR Information Systems

If companies want to include information regarding social media presentations of candidates or employees in files or HR information systems, they may be obligated to notify the candidates or employees under data protection laws in Europe and many other jurisdictions.

4. Account Access, Usage

Companies also have to ensure that they do not allow employees to use coworkers' social media accounts without assessing whether this violates the provider's terms or the coworker's rights. For example, a coworker may not find it acceptable for his or her colleague to use her Twitter or Facebook account to send marketing messages while she is on medical leave.[69]

5. Compliance

Compliance officers and in-house lawyers should determine what additional steps they should take to extend the company's overall compliance program to cover social media-related risks. For example, companies in the pharma and healthcare sector should implement processes to ensure that they adequately address reports on adverse events relating to medicines or treatments that they may receive through social media channels.[70]

6. IT Personnel

IT and security personnel should receive guidance on how to deal with social media: e.g., how to protect the company and its employees from new security threats, and how to vet safe apps that employees are allowed to download to company devices.

C. Limits of Regulation

When companies regulate social media usage by employees, they must observe applicable legal limitations. In the U.S., and many other jurisdictions, employers must respect the right of employees to engage in concerted action. In many European jurisdictions, companies may have to consult with works councils or trade unions if they want to monitor employee conduct and performance via research on social media.[71] Employees can assert rights under constitutional principles, which apply directly or indirectly in many countries and can protect an employee's freedom to complain about working conditions or coworkers.[72] But, besides such legal limitations, a perhaps even more compelling limit to regulation arises from practical realities: i.e., technologies, communication patterns and social conventions develop on new media too rapidly and chaotically for regulations to keep up, and most abuses and problems do not result from

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[69] *Maremont v. Susan Fredman Design Group Ltd.,* N.D. Ill., No. 1:10-cv-07811, *summary judgment denied* 12/7/11.

[70] See, e.g., practices recommended by www.digitalhealthcoalition.org/content/social-guiding-principles-project (accessed 25 February 2012).

[71] For example, under German law: §87 Abs. 1 Nr. 6 BetrVG; *Lützeler/Bissels*, ArbRAktuell 2011, 499.

[72] *Hispanics United of Buffalo Inc.,* NLRB ALJ, No. 3-CA-27872; BNA Privacy & Security Law Report, 10 PVLR 1297.

employee mischief but, rather, by accident or due to lack of sophistication. Even more important than regulation, therefore, is ongoing training on how employees can and should use social media, through hands-on workshops, with information on how the platforms and technologies work, case studies on mishaps and "teachable moments", role-modeling, simulating real life situations, and special coaching for spokespersons.

D. Additional Country-by-country Observations

Some additional, country-by-country, observations may be of interest. Below are country-specific highlights, such as interesting news on enforcement actions, guidelines and orders of data protection national authorities, and best practices that are worth mentioning from a practical perspective.

United Kingdom

When dealing with social media in the U.K., it is necessary to consider access requests from data subjects (e.g., individuals whose data are processed), as the national privacy authority (the Information Commissioner's Office ("ICO")) has stated that companies must respond to these requests received via social media.

Germany

In Germany, three main topics can be identified in recent judgments and enforcement activities regarding businesses' social media activities:

i. data protection;
ii. information obligations; and
iii. protection of employees.

Social media is currently the focus of some German data protection authorities. For example, the Data Protection Authority of Schleswig Holstein tried to enjoin a company from maintaining a Facebook Fan Page, but had no success in court.

Data protection must also be considered when a business is using social media plug-ins (e.g., Facebook's "like" button) on its own website. Information obligations are important, and sometimes difficult to comply with when performing social media marketing in Germany.

In general, the same rules apply to any social media presentation as to a website. Business must, e.g., include an "about us" information link that can be easily accessed in every social media appearance.

Cease-and-desist claims are regularly brought by competitors if businesses do not comply with applicable information obligations.

Employment and social media should be carefully managed: on the one hand, employers may violate data protection laws when searching social media profiles of current or prospective employees. On the other hand, a local court held an employer responsible for its employee infringing competition law when uploading company-related information on his private social media profile. It is therefore recommended that a company manage its employees' conduct on social media by issuing corresponding company guidelines.

Italy

The Italian data protection authority (Garante) has always devoted specific attention to the issue of social media. This attention has been focused, on the one hand, on the users of social media, in the sense of providing warnings in order to raise awareness of the risks of publishing personal information on social media platforms, and also in the sense of offering suggestions on how to get the best out of social media without losing control of personal information. On the other hand, the Garante has issued guidelines for social media companies, highlighting principles and rules to be complied with in order to respect subscribers' right to data protection.

Another matter to take into consideration when dealing with social media is employees making use of a company's social media accounts, and also employees accessing their personal social media pages while at work, so making use of the employer's information tools (e.g., access to the internet and a personal computer).

A company should have a social media policy in place, in order to establish who can access and change the company's social media account. This has a lot to do with management of IP rights, third parties' rights in terms of personality and image, defamation matters, communications, etc., and companies should have specific policies to regulate these matters properly.

Another issue to be carefully considered is that of personal use of social media accounts by employees while they are at work. In order to allow employees to log on to their social media personal accounts, making use of the employer's technical tools, it is necessary to have in place a specific policy.

In this policy, the employer should clarify to what extent the employee is allowed to make personal use of the company's IT system and relevant resources. It may, e.g., be the case that social media networks may be accessed for personal purposes only during non-working hours, or during working hours but only for a pre-fixed limited period (one hour, half an hour, etc.); or, alternatively, there may be no fixed period, only an indication of the fact that personal use of social media should not interfere negatively with the work duties of employees.

The social media policy should also explain if, and to what extent, the employer intends to perform monitoring activities on the use by employees of the company's IT system and relevant tools for personal purposes. Of course, constant and hidden monitoring are forbidden by operation of law. Instead, monitoring is allowed only for some specific purposes, e.g. security and organizational reasons. The conditions of monitoring should be set out in such a way that they do not represent a harmful and unlawful monitoring of employees' activity.

In order to be valid and enforceable, the social media policy should be agreed with the works council or with the competent labor office. Agreement with the labor office should be sought if either:

i. a company has no works council; or
ii. an agreement with the works council cannot be reached.

Only once the agreement with the competent labor authorities (works council or labor office) is in place can the social media policy can be considered valid and enforceable. It is then necessary to make it known and easily available to all affected employees.

Regarding subscribers to social media networks, the Garante, as mentioned above, has published some guidelines.

The first ones were dated 3 March 2008. They were released after the 30th International Conference of the Data Protection Authorities, held in Strasbourg, and propose the main concepts discussed during the conference. The latest guidelines were issued by the Garante on 23 May 2014.

According to the 2008 guidelines, the main issues when making use of social media platforms may be summarized as follows:

- when personal information is published on social media, it may stay public forever;
- users should carefully consider the extent of data sharing, since the term "community'" may have a different, and much broader, meaning in the online world than in the real world;
- in some cases, the term "free of charge" means that user does not have to pay in terms of money but pays in terms of personal information, which can be used for targeted marketing purposes;
- users should be aware of the risks stemming from collection and use of traffic data;
- users should consider the risk of revealing more information than intended; and
- users should take account of the risk of abuse of social network accounts by malicious third parties.

The 2014 guidelines represent a sort of "vademecum" for social network users, and are organized into five sections:

i. explanations of how social media platforms generally work;
ii. alerts for social media users to consider;
iii. warnings on possible harms caused by social media;
iv. 10 hints to avoid getting trapped by social media; and
v. clarifications of social media jargon.

Poland

Poland does not have specific laws regulating the operation and use of social media. As various forms of social media become more and more popular, questions concerning the rules of using social media in the employment sphere have arisen.

Using social media as a recruitment tool is becoming more common. It should be noted that, according to the Polish Labour Code, only limited information may be requested from the employee during the recruitment process. For example, asking an employee to change the privacy settings of a social network profile for the length of the recruitment period would be overstepping the mark.

In practice, employees' social media profiles that are public represent a unique source of information, and employees are often not aware that their profiles may be reviewed by potential employers.

Additionally, employers in Poland have become more aware of the fact that in order to lodge a disciplinary action related to social media against an employee, the employer would need to have solid evidence of the employee's cyberloafing. Therefore, awareness is growing of the necessity of having internal by-laws regulating the usage of social media and monitoring of employees' online activity.

The question of whether or not an employee who uses social media during working hours is violating his or her employment duties was examined by the Warsaw District Court in 2013. Upholding the legality of the dismissal of an employee, the court stated that spending a significant part of working time using social media may justify immediate summary dismissal.

Furthermore, some marketing activities on social portals have been examined by the Polish courts and authorities, in view of IP and privacy laws.

Spain

It should be highlighted that in Spain, the fact that a person has accepted being "connected" with a company through a social network does not imply consent for direct marketing purposes. Therefore, sending commercial emails to one of the company's "friends" on the social network without obtaining previous consent could attract sanctions.

For example, the Spanish Data Protection Agency (SDPA) imposed a sanction on a trader that sent a commercial communication by email to one of the individual's contacts. In this respect, although the trader claimed that the recipient voluntarily accepted being included in the relevant contacts list, SDPA considered that such acceptance did not imply consent to receiving commercial communications.

Russia

In Russia, 2013 was the year of active enforcement of internet personal data protection, according to the report of the Federal Service for Supervision of Communications, Information Technology, and Mass Media (Roskomnadzor). According to this report, Roskomnadzor conducted more than 2,400 audits of websites and processed more than 6,000 claims from personal data subjects. As a result, in more than 80 cases, it forced internet service providers and personal data operators to delete illegally distributed personal data or to block the relevant internet resources.

Starting from September 1, 2015, operators of social media websites, online postal and booking services, and other web resources that collect personal data of Russian citizens must maintain databases on Russian territory for the purposes of storage and processing of such personal data. The Russian data protection authority, Roskomnadzor, will be able to block access to websites violating this requirement.

The law does not literally require that operations involving the personal data of Russian citizens be performed solely with the use of Russian databases and does not additionally restrict cross-border personal data transmission. Based on the formal interpretation of the amendments, Russian databases may simply be "used" within the already existing data processing schemes and facilities. At the same time, due to the ambiguity of the wording of the law, enforcement practice may potentially develop in a more restrictive manner.

Brazil

In Brazil, in order to have a competitive presence in the online market, fashion and luxury brands usually make good use of social media outlets to increase their relationship with clients, and have great proximity to fashion bloggers and other influential social media personalities. The practices of establishing joint marketing actions, sponsoring trips and sending products to fashion bloggers for their review and comment are common.

However, certain precautions have to be taken with such marketing actions, in order to avoid the risk of violating consumer laws and advertising regulations. Blogs and other social media tools are frequently used to review and comment on certain products (including fashion items and cosmetics) – on the other hand, the Brazilian Consumer Defense Code and the Brazilian Self-Regulation Advertising Code require that all advertising and publicity is clearly indicated to consumers.

In fact, the Brazilian Advertising Self-Regulation Agency has been investigating unfair advertising practices in partnerships between fashion and luxury brands, and even started a proceeding against fashion bloggers who wrote very similar reviews for a certain cosmetic product (which suggested they were strongly based on a briefing or press release they received from their contractor), without expressly marking them as advertising posts.

Therefore, even though brands are allowed to partner with fashion bloggers or request that they comment on a certain product (whether or not for payment), they need to make sure that the post is clearly marked as an advertisement (or that the blogger expressly states that he or she received the product for free).

Mexico

In Mexico, the top-of-mind legal issues that have been arising from social media network activities are privacy and IP rights. Other important issues are content ownership, regulatory compliance and even criminal activity. The rapid growth of social networks has driven industries to develop or refine guidelines specifically addressing social media and overall communication activities.

No social media issue has resonated so strongly in Mexico as privacy. From a legal standpoint, whether an individual has a reasonable expectation of privacy or not is the critical factor in determining whether the activities performed are protected by privacy laws. For instance, marketing efforts, as one major means of communicating with consumers, require obtaining the prior consent of the targeted costumer. Opt-out consent is the proper way to proceed here.

Not surprisingly, given the myriad ways to access information through social media, IP infringement is an area of significant legal interest. For example, in Mexico, not only copyrights but image rights come into play when there are photos, videos, graphics and blogs being posted and exchanged on social media sites. Also, unauthorized disclosure of trade secrets, confidential information and third-party content can result in criminal and civil liability. Likewise, enterprises' activities have come under more scrutiny in regards to regulatory compliance.

Several legal issues fall under the umbrella of unauthorized activities through social media: e.g., harassment and defamation activities – the so-called "internet trolling". Mexico does not have specific rules on this issue; however, it should be approached according to the same criteria that existed before the advent of social media platforms.

Australia

In Australia, one of the highest-risk areas for an organization using social media is liability for material posted to social media platforms under the organization's control. The main areas of potential exposure are in relation to defamatory material, copyright infringement, and misleading or deceptive conduct.

The Australian regulator has indicated that it is particularly interested in the use of social media platforms to engage in misleading or deceptive conduct. The Australian Consumer Law prohibits a person engaging in misleading and deceptive conduct (or conduct that is likely to mislead or deceive) in trade or commerce.

Of special interest to the regulator are claims made by an organization that are unsupported by evidence, paid endorsements that do not accurately reflect the use of products or services by the endorser (e.g., celebrity endorsement of a product that the celebrity has not actually used), removing negative comments that have been posted by legitimate customers, and allowing untrue comments about a competitor's products or services to remain in place.

The Australian regulator is more likely to pursue organizations for alleged misleading or deceptive conduct where there is the potential for widespread public detriment if the information is relied on (i.e., where the organization has a large social media following); the conduct is particularly blatant; or the organization has previously come to the attention of the regulator. The regulator has also stated that larger organizations, with the resources to monitor social media platforms more effectively, should be in a position to address material promptly, and that where the audience for the social media is sizable, the organization will be more accountable.

Examples of action by the regulator include that taken when an Australian company allowed contractors to post fake customer reviews on its website. A fine of A$6,600 was issued and the offender was required to provide enforceable undertakings to the regulator in relation to their future behavior. In another case, a company was found liable for statements, links to statements and testimonials posted by clients on its social media platforms that made claims about the company's products that the company had been prohibited by court order from making or publishing. The company and its sole director were each fined A$7,500, directed to publish corrective advertising, and subjected to injunctions preventing them from engaging in similar behavior.

Australian employers should be mindful of their employees' use of social medial during work hours, the possibility of intentional or inadvertent disclosure of confidential information by employees on these mediums, and the legality of investigating the activities or statements of employees through their social media presence.

Organizations should also be mindful of the risk to their reputation where employees identify themselves on social media by reference to their employment relationship or position with the organization.

Employers should establish clear rules for the use of social media by employees at work. It is also highly recommended that organizations have clear rules regarding use of its own social media platforms.

Hong Kong

In Hong Kong, there is no specific legislation governing the use of social media. As such, the general content restrictions under Hong Kong laws apply to content made available on social media platforms. When using social media to advance business interests, organizations should ensure that any content posted is not obscene or indecent (as regulated by the Control of Obscene and Indecent Articles Ordinance), defamatory (as regulated by the Defamatory Ordinance) or seditious (as regulated by the Crime Ordinance).

The provisions of the recently amended Trade Description Ordinance ("TDO") will also impact the sale and promotion of goods and services via social media. The TDO prohibits any person from applying any misleading or false trade description to any goods or services.

The definition of "trade description" is very wide, and include any matters in relation to goods and services: e.g., quantity, price, availability, fitness for purpose, performance claims, warranty, charges and costs. Organizations that advertise their products on social media should ensure that information provided is truthful and not misleading. The amended TDO also creates new offenses dealing with unfair trade practices. Among these offenses, that of misleading omission is of particular relevance when organizations engage bloggers or celebrities for product endorsement in a social media environment. The contractual relationship with such bloggers and celebrities should be disclosed unless it is apparent from the context that the endorsement is an advertisement. Otherwise, the organization may commit the offense of misleading omission for failing to identify its commercial intent.

The Commissioner of Customs and Excise and the Communications Authority, as the enforcement agencies of the TDO, published the "Enforcement Guidelines for the Trade Descriptions (Unfair Trade Practices)(Amendment) Ordinance 2012", which provides guidance to organizations as to when conduct (with specific examples) may constitute unfair trade practices under the TDO.

Personal data collected from social media platforms is also subject to the requirements of the Personal Data (Privacy) Ordinance. In 2014, the privacy commissioner, having recognized the risk of online privacy intrusion has increased with the growing use of social media by businesses, published an information leaflet on "Privacy Implications for Organizational Use of Social Networks". The leaflet outlines how organizations can safeguard personal data privacy when using social networks to promote their business, and provides recommendations for good privacy practices when using social networks for marketing, customer services, HR management and network analytics. For example, the privacy commissioner has recommended that:

- where marketing involves the use of social connections (e.g., where an organization promotes to a user's contacts that the user has purchased from the organization) and behavioral tracking (e.g., where an organization profiles customers based on their preferences as social network users), the organization should make known such practices to the users and allow them to opt out of participating in such marketing processes; and
- organizations using social networks for recruitment or candidate screening should consider whether the information obtained from the social network is reliable, and can legitimately be taken into account in hiring decisions.

Japan

In Japan, as in many other countries, social media has become quite popular, and Japanese people make use of social networks for business as well as in their private lives.

Typical legal issues in relation to social networks may be summarized as follows:

i. privacy/protection of personal information;
ii. IP (most typically, copyright) infringement; and
iii. employment-related issues.

With respect to (1), privacy/protection of personal information, one of the hottest topics is the use of so-called big data; the key to correct use is whether or not information is appropriately anonymized. This issue is under ongoing discussion by government and industry.

As for (2), IP (most typically, copyright) infringement, it should be noted that an operator of a social network is likely to fall under the definition of "Specified Telecommunications Service Providers", and, therefore, the Act on the Limitation of Liability for Damages of Specified Telecommunications Service Providers and the Right to Demand Disclosure of Identification Information of Senders, which contains rules on possible limitation of provider's liability and on information disclosure by potential infringers, will apply to it.

As to (3), employment-related issues, some companies have introduced rules/guideline about social media usage in the workplace. As best practice, employers should set out clear rules and guidelines on social media usage and properly inform employees of them.

Singapore

Regarding Singapore, it should be noted that the Monetary Authority of Singapore, in its Technology Risk Management Guidelines, states that a "[Financial Institution] should not use unsafe internet services such as social media sites, cloud-based internet storage sites, and web-based emails to communicate or store confidential information. The FI should implement measures to prevent and detect the use of such services within the FI."

In addition, it should be noted that the Singapore Personal Data Protection Act provides for wide exemptions from the need to obtain consent for the collection, use and disclosure of "publicly available" information, and from the need to obtain consent for the collection, use and disclosure of personal data for "evaluative purposes" in the employment context.

E. Summary and Checklist

We strongly recommend that you keep in mind the following points and apply them as appropriate to your organization.

i. **Ask and answer** the question of whether social media use should be mandatory, which tools to use for what purposes, and which data categories employees should be required or permitted to disclose when using particular social media tools.
ii. **Contractually agree** with employees as to who shall own social media accounts and the data in the accounts, and who may access social media accounts and post from them.
iii. **Educate and train** employees regarding data security risks and other risks associated with social media tools, particularly inadvertent misuse and application errors.
iv. **Issue** clear written policies; update existing policies; and confirm whether a separate dedicated social media policy is necessary and whether it is consistent with other, existing, policies.
v. **Limit** prohibitions in social media policies, to avoid illegally restraining concerted labor activities.
vi. **Notify** employees via privacy notices how and to what extent the company monitors employees' social media use; notifying employees in Europe and other jurisdictions may be required by law if you want to include in files social media information on candidates or employees.

vii. **Plan** for social media data becoming relevant in disputes and court proceedings; take necessary steps to ensure compliance with litigation holds, etc.

viii. **Prohibit and prevent** employees from commenting on or reviewing the company's own products or services in their personal capacity without disclosing their company affiliation.

ix. **Refrain** from compelling candidates or employees to provide access credentials for accounts they own.

x. **Restrain** employees regarding the creation of (in particular, anonymous or fake) social media accounts to access another employee's, job candidate's or other person's non-public information on social media.

xi. **Remind** employees frequently that general laws and company policies also apply to social media.

xii. **Respect** and ensure compliance with social media providers' terms and conditions.

xiii. **Review** and negotiate adequate data security measures and commercial terms with suppliers of proprietary social media tools.

xiv. **Search** a job candidate's public social media profile only as legally permitted and, potentially, in a two-step process (e.g., have one HR employee do the research, and then pass on only information that can legally be used in the selection process to another HR employee, who does not have access to "raw" research data that may contain information that should not be taken into account); and, so as to adequately inform applicants, consider noting in job ads whether you conduct online research on candidates.

Chapter 5: Alternative Distribution Models and Current Trends[1]

I. Introduction

This chapter is intended to provide an overview of the various distribution models used by fashion and luxury brands to reach their ultimate consumers. The traditional distribution channels have included sales by brands at wholesale, including through department and specialty stores; sales directly at retail by brands through their own stores; distribution through hybrid models such as concession/licensed departments, and sales through franchisees. We also address some of the issues involved in selling through outlets, which have changed dramatically in recent years.

More significantly, in the last 15 years there has been a revolution in fashion and luxury brand distribution as e-commerce has taken hold of the market. Fifteen years ago most retailers had a single distribution channel – the brick and mortar store – but with the advent of Amazon and eBay, the wide use of search engines, and the use of apps on mobile devices, e-commerce opened up a new way to interact with and sell to consumers. The smartphone introduced mobile commerce, and social networks, including Facebook, Twitter, Pinterest, Instagram and the like, created new avenues for fashion brands to market to customers and establish viral brand awareness.

More and more brands are embracing an omni-channel retail strategy, which combines the benefits of an in-store presence with online purchase and delivery, including through mobile devices, to provide the customer with complete and integrated service solutions. These developments have forced fashion and luxury companies to embrace technology, both in customer relations and inventory and sales management, as they harness all the various channels through which merchandise is promoted and sold. Brands are now also moving toward integration of their data, inventory, processing and delivery systems in order to make the customer experience, including internationally, consistent and seamless. The fashion industry also has a leading role in the growth of emerging international markets, with Asia and South America targeted as key markets for luxury goods. Of course, the drive for international consistency in brand message presents numerous challenges, as legal requirements applicable to the industry differ from jurisdiction to jurisdiction.

Fashion brands and fashion retailers have also been dramatically influenced by the emergence of the millennial generation. Millennials are tech-savvy, drawn to brands that embrace their social values and engage heavily on social media networks; they voice great concern about corporate social responsibility and environmental issues; and have had a significant effect on how brands design, produce, market and advertise their products. Trends such as “fast fashion” and using eco-friendly and sustainable materials and manufacturing processes have had great sway in how the retail experience operates, in ways never before envisioned.

These developments have created a whole host of regulatory challenges and legal risks. The use of technology has also subjected fashion and luxury clients to patent infringement claims

[1] Pamela Church of the New York office is the principal author and editor of this chapter. The country specific sections of Part III were prepared by Marcia A. Calafate, Brazil; Helen Brown and Julia Hemmings, United Kingdom; Loke-Khoon Tan, He Guangyue and Yang Yilan, Hong Kong and China; and Margarita Divina, Russia.

surrounding their e-commerce operations. Notwithstanding these additional risks and challenges, the internet and e-commerce platforms have generated dividends in terms of winning brand awareness.

We begin our discussion with the traditional channels fashion and luxury brands have used to reach their consumers, and then move into the digital space.

II. The Traditional Channels: Brick and Mortar Retail Stores

A. Wholesale Sales, including Department Stores

Traditionally, because of the consumer's desire to try on apparel products, brick and mortar stores have been the mainstay for retail apparel sales. In the U.S., the department store industry has historically been a primary venue for fashion and luxury products. In recent years two factors have presented new challenges for fashion and luxury brands in dealing with their department store customers. First, there has been substantial consolidation of the main department store chains, giving the chains more bargaining power. In addition, department store sales in the U.S. have been threatened by increasing competition from internet sales, such as by Amazon and other retail channels.

Despite having long-term relationships with their brand vendors, department stores generally purchase products from brands on a purchase-order-by-purchase-order basis. Generally the department stores require brands to accept their terms and conditions. Indeed, the brand may only be able to effectuate transactions through the department store's secured website, which effectively specifies all policies, standards, terms and procedures (including electronic data interchange technology system use) for the handling of purchases. The department store policies will often include provisions specifying that the brand must comply with all of them. Care must be taken by the brand vendor to review these terms and conditions to be aware of the rights the department stores are reserving with regard to product. For example, the standard department store terms and conditions may allow it to sell the branded merchandise in any of its retail stores, and also through catalogues, mail order, or online through its website and all other websites linking or framing to its website, making use of the vendor's brand in its advertising.

Generally brand owners have their own order and acceptance confirmations, which have a variety of brand-protective provisions that are in conflict with the standard terms of the department stores. An example might be limiting the sale of the merchandise to the specific point of sale identified in the order confirmation. This leads to a "battle of the forms" problem. Under the Uniform Commercial Code adopted by virtually all U.S. states, the effective terms of an agreement between merchants are those found in common, and if an offeree includes additional or different terms in its acceptance, such terms are part of the contract unless the offer expressly limits acceptance to the terms of the offer. Since both the department store and the brand vendor often include such a limitation on additional or different terms, the effective terms that are not in common are frequently in doubt, but it is likely those of the department store will prevail in the absence of a specific side agreement on the issue at hand.

B. Branded Corners or Shop-in-shops

As stated above, department stores rarely have formal long-term agreements with vendors. One exception is arrangements for corners (otherwise known as shop-in-shops) whereby the brands co-invest with the department stores in the build-out of a section of the store devoted exclusively to the particular brand, which will have the brand's distinctive marketing concept.

Typically, individual brands use space within a larger department store to create a single brand environment, usually in close proximity to brands of similar prestige. Generally, both the brand and the department store benefit, as they share build-out and maintenance costs. However, the relationship remains a wholesale sales relationship, with the department store continuing to purchase product from the brand on a purchase-order basis and sell it directly to the public. The advantage to the brand owner is that it has dedicated space in the department store, which makes it more likely that the department store will be committed to purchasing full lines and/or a broad array of product. Sometimes the brand will insert and pay for its own sales staff to help promote the merchandise. When that occurs, both parties must be wary of and consider joint employment issues relating to such arrangements.

Shop-in-shop (or corner) agreements are often framed as licenses from the brand to the department store, as the department store is using the brand to denote the services of a particular area of the store. The brand owner will want to ensure that it has adequate control over the look and feel of the space, and the quality of the operations in the shop-in-shop, as the public will associate the corner with the brand experience. If the experience is not acceptable, the brand can be harmed. From the brand's perspective, the brand holder should ensure that specific floor space is identified in the agreement, with prohibitions on the department store moving the corner or changing it without the brand owner's consent. Moreover, build-out should be performed in accordance with the brand owner's specifications, whether or not the brand owner is actually managing the build-out process; and the agreement must specify who is responsible for maintenance and upkeep.

In addition to the physical look and feel, the brand may have control of or input into merchandising matters – the selection, presentation and arrangement of product to properly depict the brand image. The brand may provide training to department store staff and have some control over the department store's staffing (including the manager) of the corner.

Care should be taken to cover liability issues, including insurance and indemnification, in a shop-in-shop agreement, as the public may assume that the party responsible for injury (e.g., if they slip and fall) in a corner is the brand, and bring a lawsuit against the brand owner as well as the department store. Moreover, the agreement should specify what happens in the event of casualty to the department store or the space. In addition, it is important to ensure that the arrangement does not run afoul of franchise laws, which may require elaborate disclosures by the vendor and, potentially, state registration.

Lastly, the term of the arrangement should be specified, to ensure that both parties are able to recoup their respective investments in the build-out. An agreement that does not have a specific term may be deemed terminable by either party on reasonable notice.

C. Licensed Departments/Concessions

By contrast, a department store may license space to a brand, with the brand itself exclusively responsible for stocking the space and providing sales personnel. These arrangements appear to be quite similar to shop-in-shops, as described above, especially to the purchasing public, but there are very important economic differences. Essentially, the brand owner is a tenant for a specified space. The sales of branded product are effectively sales by the brand manufacturer directly to the consumer, with the department store taking a commission in the form of a percentage of the sale price. The department store accordingly bears no inventory risk. The brand owner, on the other hand, has full control over the sale of the product and can potentially realize a higher margin than in wholesale sales. For these reasons, these arrangements are popular with both brand manufacturers and department stores alike.

The term of such an arrangement is usually three to five years, with renewal options in specified circumstances; thus, it is much shorter than a normal lease, providing more flexibility both to the brand and to the manufacturer. Both parties must be wary of joint employee issues, and human resources issues regarding compliance with policies can be difficult if the policies of the brand and department store are inconsistent. Agreements often provide for employee discounts and enrollment in special customer promotions.

The key concern from the brand manufacturer's point of view is that, although it carries the inventory risk, all sales pass through the department store's point of sale and accounting system, and, accordingly, the revenue goes in the first instance to the department store, and is only distributed to the brand after the commission and all other reimbursable costs and expenses are netted out. Payments are usually made to the brand manufacturer monthly, in arrears. The handling of returns and proper adjustments can be complex. And department stores often expect minimum aggregate commission amounts to be paid, as well as thresholds for minimum annual sales. So long as the department store is solvent and remains up to date on payments, there are relatively few problems on both sides. But if the department store were to enter bankruptcy, not only is the brand at risk regarding its unpaid revenue, there could be issues in terms of retrieving its inventory, and possibly even claw-back of payments already made to the brand by the department store. The licensed department agreement should be drafted carefully to avoid or minimize these risks.

D. Directly Owned Mono-Brand Stores and Factory Outlets

Despite the online trend, fashion and luxury companies continue to rely heavily on brick and mortar stores for retail sales, some opening multiple stores per year, and relying more and more heavily on flagship stores to establish the look and feel of a brand in support of all distribution channels.

The myriad real estate law issues involved in the leasing of store space operated by a brand manufacturer are beyond the scope of this chapter. However, it is worth pointing out that while operating one's own stores allows the brand manufacturer to capture more margin, it also involves substantially more upfront cost of build-out and creates many risks, including that associated with entering into long-term leases in real estate markets, and liability relating to personal injury, casualty and employment claims.

Moreover, it is advisable to structure the business in a tax-efficient manner. Effectively, the brand manufacturer is doing business in every state in which it operates a retail store, requiring registration and subjecting the brand manufacturer to income and sales tax liability in such states.

Finally, each state has its own consumer protection laws governing everything from gift cards to return and credit policies, and recyclable bags to privacy and data protection. Rarely does one policy fit all circumstances. The bottom line is that before opening a retail store in any new locale, care must be taken to ensure that the store complies with all applicable laws.

Originally, outlet stores were opened by brand manufacturers to sell their own off-season products, seconds or overruns. More recently, outlets have become their own merchandising channel, along with discount department stores, for which some brand manufacturers launch specific limited edition products at lower price points. As a result, U.S. federal and state laws have developed regulating how brand manufacturers may lawfully advertise discounted prices on sales tags, including a “former” price to promote the “current” sale price of an item. Federal law provides that the former price must have been a bona fide price at which the item was offered to the public. Laws vary from state to state, and even city by city. Generally, the states mandate that the basis for the price comparison be clearly described on the tag: i.e., clearly listing the former price alongside the discounted price and specifying when the former price was valid.

E. Franchises

The fashion industry has long relied on franchises for product distribution. A typical franchise provides for a license of the brand and a uniform business system that the independent franchisee must adopt. The licensee is generally required to carry only the licensor’s products in the stores, in an assortment that is consistent with the range of products available in the licensor’s other retail stores. The brand manufacturer provides training, marketing support and materials, operation manuals and ongoing support and supervision. The licensor generally has approval rights over the lease for the store, the architecture and contracting, and the planning and operation of the stores. The brand manufacturer also sells the franchisee all the product, and often fixtures and equipment as well. The franchisee often bears substantially all of the capital costs, although sometimes build-out costs will be split. The licensee may be required to pay an initial license fee as well. Usually it does not pay a royalty, as it is required to purchase all inventory from the licensor or its designee.

Franchising is highly regulated in the U.S., both at the federal and state levels. The Federal Trade Commission adopted a Franchise Rule that requires every franchisor to deliver a franchise disclosure document unless the proposed transaction comes within some specified exceptions.

The first issue is whether the arrangement in question constitutes a “franchise”. Under the Federal Trade Commission’s amended Franchise Rule, a business arrangement is a “franchise” if it satisfies three definitional elements: 1) franchisor promises to provide a trademark or other commercial symbol; 2) franchisor promises to exercise significant control or provide significant assistance in the operation of the business; and 3) franchisor requires a minimum payment of at least $540 during the first six months of operation (excluding payments for purchase of reasonable amounts of inventory at bona fide wholesale prices for resale.)

There are some exemptions to required disclosure, which might apply depending on the facts. If, for example, the franchisee has more than two years experience in the same type of business and the parties anticipate that the sales arising from this arrangement will not exceed 20 percent of franchisee's sales, then it may qualify for the "Fractional Franchise Exemption". Alternatively, if the franchisee is making an initial investment of more than $1.0849 million in the proposed store, then the arrangement may be exempt under the "Large Franchise Investment Exemption". Lastly, if the franchisee has been in business for at least five years and has a net worth of at least $5.4245 million, then it may qualify for the "Large Franchisee Exemption".

In addition, many states have their own franchise laws, which not only require delivery of a disclosure document but also often require that the franchisor register the disclosure document with the state before it can offer franchises there. Many states also have laws governing the relationship of the two parties, including when and how a franchisor may terminate a franchise. These potential limitations on terminating a franchise can create obstacles when a franchisee fails to comply with quality control requirements. They also present obstacles when brand manufacturers seek to recover ownership of stores in an effort to secure more complete control over the brand in the retail environment.

Often, franchise systems involve a particular franchisee covering a specific geographic territory. This can put the franchisor at risk when the franchisee begins to run behind on payment. The legal restrictions on termination of a franchisee can put a franchisor in a difficult position – to protect the brand, it must not let the store's inventory and appearance decline; but there can be obstacles or delays in taking over the operation of the store. To avoid being put "between a rock and a hard place" care must be taken in the drafting and negotiation of the relevant franchise agreement to maximize the franchisor's rights to protect the brand and take over the store in a manner that is compliant with the applicable law protecting the franchisee's interests.

Another problem is the vicarious liability the licensor brand may be exposed to by reason of the actions of its franchisee. Consumer protection laws in many states are ever expanding, particularly in the areas of privacy and data protection, gift certificates and consumer relations management. Many "private attorney general" claims, taking the form of class actions, are being filed to enforce them. Often, the brand owner is included as the defendant, and is the deep pocket. In negotiating franchise or license agreements with a third-party store operator, the brand owner should clearly specify the areas in which the licensee has sole responsibility (e.g., compliance with state local laws) and provide itself with adequate indemnities for such claims.

III. The New Channels: E-commerce, Online Shops and Mobile Apps

Generally, e-commerce transactions are subject to all of the same laws as are brick and mortar shop transactions. The same issues involved in the sale of goods as set forth in the Uniform Commercial Code, as adopted by the various states of the U.S., apply to e-commerce sales.

However, some other laws have been adopted that expressly address the e-commerce environment. The Electronic Signatures in Global and National Commerce Act, a federal statute, recognizes the validity of electronic signatures and electronic records in interstate and foreign commerce. Moreover, all states of the U.S. have adopted electronic signature laws to recognize the validity of electronic signatures and records.

As is widely known, websites typically use either a "clickwrap" or "browsewrap" agreement to contractually bide users to the website's terms. A "clickwrap" requires an express affirmative acceptance of the terms through the click of an "I agree" button. A "browsewrap" is a posting of the website terms, which states that use of the website acknowledges acceptance of the agreement. Both have been held to be enforceable in circumstances where the terms and conditions are readily accessible, visible and clear, and the user is adequately prompted to review them (even if he or she doesn't). However, clickwraps are more likely to be upheld than browsewraps, and, accordingly, are more popular. Generally, the more conspicuous the terms and the greater the evidence the consumer has seen them and accepted them, the less likely a court will find them unenforceable. We now turn to the legal issues involved in developing e-shop websites and mobile applications.

A. Online Shops

Typically, a brand builds its e-commerce store as part of its website, as the domain name for the site drives the purchasing traffic to the brand's e-commerce store. A retailer might develop its e-commerce site internally, but more typically will enter into a design and development agreement with a third-party software developer, as many have packaged solutions and the ability to provide a multiplicity of related services. The services agreement with the third-party developer for the creation, hosting and operation of the e-commerce platform should address all of the following areas: the design, development and set-up of the shop, complete with milestones; the hosting and operation of the platform, with provisions addressing service levels and service deficiencies; fees and payment terms; monitoring and reporting; direction and inspection rights; intellectual property and infringement matters; data protection and privacy, insurance and liability, indemnification; and, as applicable, how the provision of other services, such as order processing, order fulfillment, payment, sales tax collection and remittance, and possibly even marketing services, will be handled. Some arrangements may include inventory and warehousing services and financial services as well.

There are many critical issues to be addressed in the negotiation of the agreement with the website developer. In the first instance, it is important that the specifications of the e-shop are carefully prepared and reviewed, and that milestones are set up for development, which, ideally, are conditions for payment of fees relating to the development.

Another key issue is the ownership of the software and content used in the e-shop platform, and assurance that when the platform is transferred, e.g., through being "in-sourced" or transferred to another hosting provider, the e-shop will seamlessly transition to the new environment without interruption of service. The brand owner should ensure that it owns or has a perpetual license to the content and software it needs for such transmission, and that the developer/hoster is obligated to assist to ensure the transition will be successful and seamless.

Allocation of responsibility for legal requirements, and for infringement claims, is key. Brands have recently found themselves the targets of patent troll litigation relating to technology used in their e-commerce platforms. It is important to obtain solid indemnification rights relating to infringement claims, as the developer is in the best position to defend such claims. Indeed, usually it is defending numerous such claims on behalf of many of its customers.

The e-shop website must include the terms of sale/terms of use covering payment and ordering processing, shipping, return and exchange policies, dispute resolution, choice of law, forum selection, limitation of liability, and trademark and copyright policies. Separately, the e-shop website must also contain the brand's privacy policy, which would include treatment of security of personally identifiable information, data collection, the use of customer data, the extent to which such data is shared with third parties, and opt-out policies: e.g., with respect to behavioral advertising and use of cookies. (Privacy and data protection matters are looked at in more detail in Chapter 3.)

B. Mobile E-commerce

In order that e-commerce content may be made available on smartphones or tablets, many brands have created mobile commerce applications, or “apps”. Mobile apps enable brand customers to engage in shopping through their phones, including reviewing products and pricing information, checking customer product ratings, scanning barcodes in stores and completing product purchase through the app. As an app runs locally on a device, it must be designed for a specific operating system. Consumers download the apps through the relevant app store. Accordingly, a retailer must enter into a developer agreement with the operator of the app store.

App store agreements are usually entered into through a clickwrap process and the terms are not generally negotiable. They deal with such matters as revenue sharing, advertising, privacy and security, as well as technical requirements, and circumstances resulting in suspension and termination of the app.

As in the case of the e-shop website, the brand might internally design and develop the app or outsource the design and development to a third-party service provider. Critical issues, of course, include the matter of ownership of the software code and other intellectual property making up the app, and the extent and quality of ongoing support for the app.

IV. Using Special Promotions (Sweepstakes, Contests, Charitable Promotions and Other Methods) to Drive Traffic and Increase Cross-Channel Involvement – Regulatory Hurdles

It is very common in the fashion business for brands to use contests, sweepstakes and charitable promotions to drive brand awareness and increase customer interaction. These types of promotions have become ubiquitous in the e-commerce channel. They are, however, highly regulated. In each case, the promotion in question must be analyzed to ensure it does not violate federal or applicable state law.

A. Sweepstakes and Contests

Both at the U.S. federal level and in all 50 states, the three following elements will cause a sweepstakes or other promotional giveaway to be considered an illegal lottery: (a) prize, (b) chance and (c) consideration. The definitions of each of these three elements differ among the states and may also be different from the definitions found under the applicable federal law. Brands endeavor to eliminate from any sweepstakes or other giveaway one of these three elements, so as to fall outside the scope of lottery regulations. Prize is the attraction in any sweepstakes or other giveaway and cannot be eliminated. Chance can be eliminated by making an event a game of skill or contest, through, e.g., requiring submission of creative content, such as a photograph. Consideration, e.g., payment, is the most commonly eliminated element.

When the element of chance is eliminated, the game becomes a contest or, as it is otherwise called, a “game of skill”. In a majority of states, the element of chance will be considered to be eliminated if skill is the primary element of the game. However, in a minority of states, chance will be considered present if any portion of the contest is conducted by it. In crafting a contest or game of skill, the following points should also be noted: the subject matter of the contest must be one that requires the skills of the general class of participants and not those of an expert. Qualified judges should be selected, to maintain the objectivity of the contest; the criteria and the weight given to each element comprising the criteria should be specified; and, in the case of a tie-breaker, the winner must be determined by skill, or both finalists must be awarded duplicate prizes.

When the element of consideration is eliminated but chance remains, the game becomes a “sweepstakes” or “game of chance”. Depending on state law, consideration can vary, from purchasing products and services, to making a substantial expenditure of time and effort, including completing a survey, or visiting a store. Online sweepstakes often require an entrant to complete forms aimed at gathering demographic information, or require an entrant to “click” on banner advertisements (often for sponsors of the site) in order to enter. There is variation from state to state on whether and to what extent such requirements could be called consideration.

Certain states have registration and bonding requirements. Unless the sweepstakes is to be void for residents in Florida and New York, a retailer will have to register its sweepstakes in these states whenever the prizes exceed a value of $5,000, by filing with the state information including the rules and regulations governing the promotion and a description of the prizes. Such filing must be done at least seven days prior to commencing the sweepstakes for Florida and 30 days for New York, both with filing fees. Additionally, both states require that a trust fund or a surety bond be established in an amount equal to the total value of the prizes offered.

Rhode Island requires registration of sweepstakes offered by brick and mortar retail establishments when prizes are in excess of $500. Retail establishments are defined as all retail establishments that sell to consumers directly, and that offer a game of chance to the general public as a whole, as a means of promoting their business. Such retail establishments must file information including the rules and regulations and the value and the number of prizes to be awarded, together with a fee.

Apart from the Federal Trade Commission’s laws and regulations on unfair competition and deceptive acts or practices, many states have adopted their own disclosure regulations in this area. Such laws generally require operators of sweepstakes and other prize promotions to provide a written notification to participants that clearly and conspicuously discloses certain information. Among the required information are the name and address of the promoter and sponsor, a verifiable retail value of each prize and the odds of winning, fees for receiving the prize, restrictions, limitations on eligibility, the method and date of determining winners, and a statement that no purchase is necessary. Such information is ordinarily contained in the rules for each sweepstakes that are available to the entrants.

A key element in complying with federal and state disclosure requirements is ensuring that the rules that will govern the sweepstakes or contest being conducted are sufficiently disclosed whenever and wherever the sweepstakes or contest is promoted and that such rules are strictly followed. The critical point here is that claims in the promotion must not in any way be misleading, such as by inflating or misstating the value of prizes to be awarded.

Many states, such as Arkansas, treat the rules for contests that are part of advertised promotions as binding contracts. Thus, the rules must be drafted with the utmost care, so that the giveaway is carried out in compliance with the drafted rules, while, at the same time, allowing for flexibility on the part of the organizer in the event of unforeseen circumstances, in order to avoid any claims for breach of contract. The rules should also include liability disclaimers.

Another issue arising under contract law relating to sweepstakes and contests is the need for various waivers, and other documents, to be signed by the winners of the sweepstakes or other giveaways. Industry practice ordinarily requires winners to execute affidavits affirming their eligibility, and a publicity and liability release. For this reason, the rules should include the requirement of obtaining from the winner an affidavit of eligibility, which indicates that the winner has complied with all the rules, and a publicity and liability release. Similar documents should also be obtained from any companion of the winner, if the prize (such as a cruise for two) is intended to be enjoyed by them as well.

Finally, all records relating to the sweepstakes should be maintained. Some states, such as Florida and New York, require the operator to file the list of winners, the prizes awarded, and the date of the delivery of such prizes, while others require such information only upon request by the Secretary of State. As the length of time for which records must be kept varies among the states, the general practice is to maintain the records for three years after the completion of the sweepstakes.

B. Charitable Promotions and Coventures

In recent years, charitable sales promotions have become an increasingly popular way for fashion companies to foster commercial goodwill through the support of charitable causes. Companies that may not have traditionally engaged in such promotions are frequently surprised to learn of the broad regulatory schemes applying to solicitations that raise funds, directly or indirectly, for charitable organizations.

Currently, most states and the District of Columbia have charitable solicitation statutes. These laws cover a wide range of “solicitation” activities – including charitable sales promotions – and can subject violators to significant fines and even criminal penalties. Many require companies making charitable solicitations to include certain terms in the contract with the charitable organization; to make prompt transfers of funds and written accountings of all funds received from the promotion to the charitable organizations, to make written disclosures in advertising; to file documents with state regulators before and after the solicitation; to consent to jurisdiction in states where the solicitation is made; and to retain fiscal and solicitation-related records. Thus, any company planning to run a charitable sales promotion should, sufficiently in advance of any solicitation, evaluate the extent to which the promotion will implicate charitable solicitation laws and take steps to ensure compliance.

Generally, a “charitable sales promotion” is an advertising or sales campaign representing that the purchase or use of goods, services or any other thing of value will benefit a charitable organization or purpose. A “charitable organization” generally means a tax-exempt organization as described in section 501(c)(3) of the Internal Revenue Code, or one that purports to be established for a charitable (e.g., benevolent, educational, eleemosynary, public health, humane, patriotic, philanthropic, religious) purpose or employs a charitable appeal as the basis of a solicitation.

Charitable sales promotions are structured in many ways. For example, a sponsoring company might advertise that it will donate a certain portion of the proceeds of a purchase to a charitable organization or that it will donate a specified amount to a charitable organization for a specified number of items purchased. Often such sponsoring company may be considered a “commercial coventurer”.

Many states regulate charitable solicitations made by “commercial coventurers”. Generally, a commercial coventurer is a person who “for profit or other consideration is regularly and primarily engaged in commerce other than in connection with soliciting for a charitable organization” and who conducts a charitable sales promotion. In some of these states, commercial coventurers are required to register and file annual reports.

It is important sponsoring brands consider that some states without a specific definition for “commercial coventurer” have attempted to regulate charitable sales promotions by interpreting other statutory definitions such as “professional fund raiser” very broadly. Charitable solicitation statutes impose significant registration obligations on “professional fund raisers/solicitors”. Professional fund raisers/solicitors are often defined as those who, for pay, for financial consideration or for compensation, solicit, or employ someone to solicit, contributions for a charitable organization. Fundraising counsel and professional fund raisers/solicitors typically are required to register annually and post a bond in states where solicitations will be made, make disclosures with solicitations, have a written contract with the charitable organization and file it with the state, maintain financial records, and report to the charitable organization and the state. Thus, an important threshold consideration for regulators is whether the party making the charitable solicitation is paid or compensated in exchange for its efforts.

Regulators in some states have informally taken the position that sales promotions result in a certain amount of goodwill being acquired by the sponsoring brand, that consumers have a propensity to make a purchase if it will benefit a charitable organization, and that as a result the sponsoring brand achieves increased sales. These benefits, the regulators contend, can constitute “consideration” and render the sponsoring company a “professional fund raiser/solicitor” subject to registration, bonding and other requirements.

In summary, brands engaging in charitable promotions should assume they will have to: (1) enter into and file with the charitable organization a written contract containing mandatory terms; (2) register annually and possible post a bond in some states; (3) possibly file other solicitation-related documents with the state; (4) make written disclosures in advertising and promotional materials; and (5) retain records of solicitation activities.

C. Endorsements and Testimonials in Advertising

The internet and social media have provided brands with an enormous opportunity to use the gathering of endorsements and testimonials of consumers to enhance brand awareness and promote sales. It has always been federal law that they have to be truthful and not misleading. But the Federal Trade Commissions’s Guides Concerning the Use of Endorsement and Testimonials in Advertising were revised in 2009, and again in 2013, to address social media use such as on blogs.

In particular, they require any connection between the endorser and the seller of the product to be fully disclosed. This would include any obligation to post something about the product or service. So, e.g., if the endorser were an employee of the seller, or were paid or received the product for free in return for providing the endorsement, that would have to be disclosed.

Such disclosure must be clear and conspicuous, disclosing the payment or compensation offered in exchange for the endorsement, or the benefit that would be extended to the endorser in exchange for the endorsement. More recent guidance says the disclosures should be “as close as possible” to the relevant claim: e.g., avoiding use of hyperlinks.

The guides apply to anyone providing an endorsement or testimonial, including the seller of the product, its employees and its contractors, and the seller is responsible for the acts of the employees that violate the guides, whether it was aware of them or not. The guides apply as well to negative testimonials as well as positive ones. The key is to disclose if the endorsement or testimonial is biased.

Noncompliance results in administrative action, and can be punished with penalties ranging from a written warning up to significant civil fines. In addition, many state attorney-generals have been commencing administrative actions for such activity.

V. Special Regulatory and other Legal Challenges

A. Latin America, Europe and the Asia-Pacific

Brazil

Introduction

From a Brazilian legal standpoint, most of the distribution models used by fashion and luxury brands in their sales in the U.S. are also available in Brazil, subject, however, to certain variations depending on matters that concern Brazilian public policy. Below we highlight the most relevant differences in comparing Brazilian laws to the U.S. legal environment.

Distribution Channels

First of all, please note that the traditional channels (i.e., brick and mortar retail stores) are the most typical distribution channels in Brazil. It would be more typical in Brazil for fashion and luxury brands to sell through directly owned mono-brand stores located in premium high-end streets and malls than through department stores, but both occur. The same types of concerns applicable in the U.S. in regards to regulatory, tax and labor implications are applicable in Brazil, which is known to have a complex legal system.

Outlet stores have recently been introduced in Brazil and the public is quite receptive to them. Historically, the brands used to sell their off-season products at the same stores that sell the new collections, but at a discount. Brazilians are not familiar with the concept of seconds, as the Consumer Protection Code (the CDC) embodies the concept that all products and services shall be of good quality and without defects. However, if the consumer is clearly informed that the product has minor defects and is being sold at a discount, this is legally permissible.

Brazil does not have many department stores chains but the major ones impose on brand manufacturers their purchase terms and conditions in a manner similar to what happens in the U.S.

Branded corners and shop-in shop concepts for fashion and luxury brands are becoming more popular in Brazil. They are implemented under a typical arrangement whereby the brand contributes funds to be used by the department store to customize a certain area of the point of sale according to the brand's distinctive look-and-feel concept. In this case, the department store or reseller will continue to purchase the products from the manufacturer or master distributor and resell them to the customers, bearing the customer's credit risk and being liable for the management of inventory (although there could be an arrangement between the parties entitling the store to return past collections for a credit note).

It would not be common in Brazil to have a structure where the brand has a branch inside the department store but the effective sale transaction is centralized by the department store, as this type of structure raises several tax and regulatory concerns. In other words, under a tax standpoint it would be quite complex (and probably not cost-effective) to have an arrangement whereby the department store could use the same cashier to invoice (and issue the tax slip) and collect payment on behalf of the brand for the sales of other products. It would be more viable from a legal standpoint (although some concerns still apply) for the brand to have a separate cashier and issue the invoice and collect the payment for the products being sold by it apart and separate from the sales made by the department store, although this could have an adverse impact on the customer experience. In any instance, the department store would be entitled to receive rent for the lease of the space, which could be a fixed amount or a percentage of the income/profits made by the brand owner, or a mix of both.

Another distribution channel legally available in Brazil is the organization of a network of franchisees. In Brazil, a franchise has been legally defined as the system through which a franchisor grants to a franchisee the right to use the franchisor's trademarks or patents, along with the exclusive or semi-exclusive rights to distribute products or services and, in some cases, also with the right to use the technology for the implementation and management of specific businesses or operating systems developed by the franchisor.

Franchise agreements are subject to registration with the Brazilian Patent and Trademark Office (INPI) to be effective vis-à-vis third parties. The Brazilian Franchise Law sets forth the franchisor's obligation to convey to the potential franchisee the corresponding franchise, offering letters with certain information on the franchise, which must be delivered to the franchisee at least 10 days before the execution of the contract (or letter of intent) or before any payments from the franchisee to franchisor are made.

In the case of an agreement with a foreign licensor or supplier of technology, the registration with the INPI is also a condition precedent for the remittance of payments abroad and deduction of payments by the Brazilian licensee or recipient. After registration with the INPI, such agreements must also be registered with the Central Bank of Brazil, as they call for payments in foreign currency.

Sales through an Electronic Platform

Basically, the same legal conditions applicable to physical purchases apply to purchases through electronic platforms, although some other restrictions are imposed on the merchant and additional rights are attributed to the consumer. All of them, however, are consistent with the principle of protection of the vulnerable party, which is the consumer. Concerns similar to those applicable in the U.S. for sales through electronics platforms would apply to Brazil.

Recently, Federal Decree No. 7,692/13 was enacted, which promulgates rules on e-commerce. This e-commerce decree provides rules on collective purchasing, right of retraction and data protection, and imposes specific duties and behaviors on suppliers who offer products and services online.

Specifically regarding the purchase of products out of the point of sale (e.g., by telephone or through an e-commerce platform) the Brazilian Consumer Defense Code provides that the consumer is entitled to return the product within seven days from the date of its receipt and receive back the price paid, with some adjustment.

Promotions

As in other jurisdictions, the conduct of promotions (through sweepstakes, contests and comparable offerings) is highly regulated in Brazil.

Brazilian Federal Decree nº 70,951/72, which regulates Law nº 5,768/71, along with Administrative Ruling 41/2008 and Ordinance 422/2013, govern certain types of promotions in Brazil. In general, promotions that encompass the giving of gifts for free for marketing purposes are subject to prior authorization. The Brazilian public institution Caixa Econômica Federal (CEF) regulates promotions carried out by commercial and industrial companies, and the Secretariat of Economic Monitoring of the Ministry of Finance (“SEAE”) controls promotions carried out by financial institutions and similar businesses.

The granting of the authorization requires that the promoting company does not have outstanding debts with municipal, state and federal tax departments, and is cleared with the social security agency. To file the request for authorization, the company must present several documents and information about it and the intended promotional initiative (type of contest, initial and final dates, prizes, etc.), as established in Annex I and III of the Administrative Ruling 41/2008. Once the authorization is granted, the company must pay a Prize Distribution Fee in an amount equivalent to 5 percent of the total amount of the prizes, and must follow the approved promotion plan. The authorization is valid for 12 months. Lack of payment of the Prize Distribution Fee, or breach of the approved plan, will subject the company to different types of penalties, depending on the breach.

Promotional plans that, according to article 11, items V and VI of Law 5,768/71, may cause an exaggerated expectation of obtaining the prizes, or that may have an adverse educational impact on childhood and adolescence, should not be approved.

There are some exceptions to the need for such prior authorization, which is the free distribution of prizes as a result of exclusively cultural, artistic, sports or leisure contests, which neither subject the consumer nor winner to any chance factor, nor require payment, purchase or use of any kind of product, right or service. Contests that require the contestant to fill in forms aiming at further commercializing of his or her data or contests exclusively for pre-defined clients or buyers are not deemed cultural contests. Ordinance 422/2013 clarifies which initiatives are not considered artistic, cultural, sports and recreational, therefore requiring authorization by the authorities.

All gifts or prizes must be legally manufactured or imported into Brazil, but it is not mandatory that they were previously available for sale, except in certain specific circumstances (i.e., toys or gifts accompanying children’s meals must be available to be sold separately).

Note that the relevant rules of the Brazilian Consumer Protection Code must always be observed (i.e., advertisements and information about the promotion must be easily understandable and visible to the public in the Portuguese language, the number of items or period of the promotion must be clearly communicated, prices be established in reais, legal warranty apply also to the gifts/prizes.).

Further, depending on the location of the store, mainly if it is in a shopping mall subject to condominium rules, it is necessary to verify such rules for certain types of promotion. There are certain shopping centers in Brazil that concentrate all the sales promotions (such as a red pencil or a season sales general effort) in certain periods/weeks.

Charitable promotions are also available in Brazil, although it would be necessary to understand and disclose the structure being used by the brand manufacturer to contribute upon the sale or other transfer of the products. Typically, it would be implemented by means of a donation, in which case certain tax consequences (or benefits) would apply. However, if the intent is to contribute money in exchange for the right to advertise the financial aid, then other restrictions may apply.

Consumer Protection in Brazil

One of the most important legal landmarks in Brazil was the enactment of the CDC. In general terms, the CDC is a protective law with principles and duties intended to look after the “vulnerable party” in the relationship (the consumer). It would definitively apply to the relationship between a fashion or luxury brand and its customer, as it establishes rules on the basic rights of consumers with respect to the quality of products and services; suppliers’ liability for defects; general commercial practices (advertisements, abusive practices, contractual protection); criminal infractions; administrative penalties; as well as establishing rules for individual and collective lawsuits on consumer matters.

The CDC requires protection of consumers’ health and safety as a basic consumer right, clear and adequate information on the primary characteristics of products and services, protection against abusive and misleading advertisements, modification of contractual clauses that impose disproportionate duties on consumers, effective indemnification for damages to property, as well as for moral, individual, collective and natural damages (full reparation rights), access to judicial and administrative courts for the full prevention of and reparation of damages, and the adequate rendering of public services.

All advertisements must be designed in such a way that consumers will be able to easily and immediately identify them as advertisements of products and services, and they are treated as a binding offer of the supplier. The CDC expressly forbids abusive and misleading advertisements: e.g., those that incite violence, exploit fear or superstition, profit from the immaturity in judgment and inexperience of children, disregard environmental values, or that can lead consumers to behave harmfully or hazardously with respect to their health or safety. Misleading advertisements are those that are totally or partially false, or that for any other reason, even by omission, might lead consumers to err with respect to the nature, characteristics, quality, quantity, attributes, origin, price and any other data about the products and services.

The CDC is applicable whenever there is a consumer relationship between the parties involved, characterized by the existence of a product or service offered to consumers by a supplier. The CDC defines "supplier" as any private or public individual or legal entity, Brazilian or foreign, that is part of the supply chain (anyone who manufactures, assembles, creates, builds, transforms, imports, distributes or markets products, or renders services, to consumers). For Brazilian purposes, either an individual or a legal entity can be a consumer to the extent that it acquires or uses the product or service as an end user.

The CDC establishes a strict liability regime, which means that the consumer will not have to provide evidence of the supplier's fault, only the connection between the damage and the action/omission of the supplier. As a general rule, all participants in the supply chain may be held jointly liable. Generally, administrative penalties against suppliers include fines, product seizure, destruction of the product, cancellation of product registration with the competent authorities, prohibition on manufacturing the product, suspension of product or service supply, temporary suspension of the activity, revocation of concession or permission to use, cancellation of license for the establishment or activity, total or partial closing down of the establishment, work or activity, administrative intervention, and imposition of counter-advertising. Please note that such penalties may be applied cumulatively.

With regard to the contractual clauses, the CDC specifies that they shall always be interpreted to the benefit of consumers, prohibiting abusive clauses that place consumers at a disadvantage. Abusive clauses can be declared null by judges and/or authorities even if consumers do not expressly require it. Also, the list of abusive clauses mentioned in the CDC is considered exemplificative, which means that authorities and/or courts may give their own interpretation of whether a clause is abusive or not. Some examples are: (i) those that prevent, exempt or reduce suppliers' liability for defects of any nature in products and services; (ii) those that transfer responsibility to third parties; (iii) those that require the compulsory use of arbitration; and (iv) those that make it possible for the supplier to directly or indirectly change the price unilaterally.

United Kingdom

Introduction

This section highlights where commercial practice and English law vary from the U.S. position set out in the preceding section.

The Traditional Channels: Brick and Mortar Retail Stores

Overall, the arrangements for sale of retail apparel in the UK follow the same pattern as the U.S., with the following variations:

i. Department stores are never keen to enter into distribution agreements with brands other than large key brands. Where an agreement is entered into, it will often be on the brand's standard terms, with a negotiated side letter dealing with store specifics.
ii. With regard to the brand corners (or corner units, as they are referred to in the UK), they are essentially still distribution arrangements, but brands tend to be able to insert more detailed provisions setting out the look and feel of the sales area and overall customer experience. Increasingly in the UK, brands will manage (and pay for) corner unit fit-out.
iii. Department stores in the UK will frequently require a right to relocate corner units within their store, to avoid any risk of tenancy/lease rights being created.

iv. The major trend in the UK within department stores is the move away from a distribution-based sales channels toward the concession arrangement. Ten or fifteen years ago, concessions would occupy a minority of store floor area. Now, in some department stores, concessions form well over 60 percent of floor area.
v. Concession arrangements are generally rolling contracts with six months notice period but are sometimes longer, depending on the bargaining power of the brand. Department stores are keen to avoid long-term arrangements, which may raise tenancy/lease issues. For this reason, the department store will always grant a license to occupy, with a right to re-enter at any time.

The New Channels: E-commerce, Online Shops and Mobile Apps

Online sales have taken off in the UK and across Europe. They account for 11 percent of all retail sales in the UK (Office for National Statistics August 2014).

Along with this, retailers have developed new logistics and delivery methods to offer the consumer a swift (often next day) and flexible delivery guarantee. In particular, many established brick and mortar retailers are offering a "click and collect" service, which allows customers to order online and collect in-store the next day. Online-only retailers have offered a similar service through third parties such as CollectPlus and Doddle, or tie-ups with other brick and mortar retailers.

Consumer Protection

Unlike in the U.S., consumer protection laws are implemented at a national level (with some variation in Scotland and Northern Ireland). The key pieces of consumer protection legislation are:

i. Sale of Goods Act 1979 (SGA) incorporates a number of statutory terms into any contract with a consumer, including that any goods purchased will be of satisfactory quality and fit for purpose. These terms cannot be excluded or restricted where a business enters into a contract with a consumer. The SGA also stipulates the remedies the business must make available to the consumer.
ii. Unfair Terms in Consumer Contract Regulations 1999 (UTCCRs) apply a test of fairness to all standard terms used by businesses in contracts with consumers. A standard term will be unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.
iii. Consumer Protection from Unfair Trading Regulations 2008 (CPRs) set out rules on how goods and services are promoted and sold to consumers. The CPRs apply to any act, omission or other conduct by a business in connection with the promotion, sale or supply of a product or service to a consumer, whether before, during or after a contract has been concluded. They contain a black list of 31 specific unfair and aggressive practices that are banned outright.
iv. Consumer Contracts Regulations 2013 (CCRs), which came into force in June 2014, require a business to provide certain information about the goods or services before the contract is concluded ("information requirements") and give certain additional rights to the consumer where the contract is concluded at a distance (including online). (See below for further details.)

A major overhaul of consumer legislation is underway with the Consumer Rights Bill, which is likely to come into force before the end of 2015. This new piece of legislation aims to consolidate consumer law into one statute, recognize the separate categories of goods, services and digital content, and give consumers clearer rights to reject goods and obtain a refund where the goods do not conform to the contract.

One further point that is worth noting: under English law, a consumer has no right to return an unwanted item to a store if he or she has simply changed his or her mind (this is not the case for online or distance sales – see below). However, it is common market practice that stores allow consumers to return unwanted goods for a period of either 14 or 28 days and, provided the consumer has his or her receipt and the goods are unused, receive a full refund.

Discounting and Sales Markdowns

The UK regulations relevant to price markdowns are:

i. The CPRs include provisions preventing businesses from misleading consumers about the price of a product or the manner in which the price is calculated, stating sales are for a limited time only, or stating that it is a closing-down sale when in each case it is not.
ii. Trading Standards Institute Pricing Practices Guide gives detailed guidance on price comparisons (a price used as a basis for comparison must be the most recent price available for 28 consecutive days or more), introductory offers, limits on when "half price sale" or "up to 50% off" can be used (only when 10 percent or more of stock is available at that discount).
iii. Code of Non-broadcast Advertising, Sales Promotion and Direct Marketing (CAP code) is a set of self-regulatory advertising rules that also covers comparisons with competitors and price comparisons.

Franchising

In the UK, there is no specific regulation of franchising.

What regulation there is, is self-regulatory. The British Franchise Association (BFA) is a voluntary body for the UK franchise industry, which promotes ethical franchising practice in the UK, as set out in its Code of Ethics (which is modeled on the European Code of Ethics for Franchising).

Online Selling

In addition to the consumer protection laws briefly described above, there are rules that apply to online selling. These are set out in the E-Commerce Regulations 2002 and the Consumer Contract Regulations 2013, and include that:

i. the business must provide the consumer with information about the goods or services being purchased and the means by which the consumer can contact the business (including full business name, geographic address and email);
ii. (subject to certain exceptions) the consumer has a 14-day right of withdrawal from a contract, where he or she can return the product and retain a full refund;
iii. the business must provide specific information about how the consumer can exercise his or her withdrawal right and provide a model withdrawal form; and

iv. the purchase flow must provide the consumer with certain information at certain points during the purchase process. This includes rules around what wording is on the payment button (“buy now”, “pay now” and “confirm purchase” are all acceptable, but “register”, “confirm” and “order now” are unlikely to meet requirements).

Sweepstakes and Contests

The Gambling Act 2005 regulates and, in some cases, prohibits betting, gaming and the operation of lotteries in Great Britain (NB: the Act does not apply to Northern Ireland).

The Gambling Act defines two types of lottery: a simple lottery and a complex lottery.

A simple lottery is one where: (i) persons are required to pay to participate; (ii) one or more prizes are allocated to the participants in the scheme; and (iii) prizes are allocated wholly by chance.

A complex lottery is one where: (i) persons are required to pay to participate; (ii) one or more prizes are allocated to the participants in the scheme; (iii) the prizes are allocated by a series of processes; and (iv) the first of these processes relies wholly on chance.

Any scheme that falls within either of these definitions needs, if it is to be organised lawfully, to operate within the statutory provisions relating to lotteries in the Gambling Act. Essentially, lotteries are permitted in only very limited situations (e.g., charity lotteries, private society lotteries, the state-run National Lottery).

Promotions or competitions that fall outside the definition of a “lottery” are those where it is free to enter.

An arrangement is a lottery only if the participants are required to pay to enter. Therefore, *free draws* are not lotteries and are exempt from regulation under the Act.

Payment is defined as paying money, transferring money’s worth, or paying for goods and services at a price or rate that reflects the opportunity to participate in the arrangement. It also includes payment required to discover whether a prize has been won, or payment to claim the prize itself (unless the payment relates to incidental costs to use the prize). For the purposes of the definition, it is immaterial to whom the payment is made or who benefits from the payment.

An arrangement is a lottery only if winning/success is determined wholly by chance (or, in the case of a complex lottery with more than one stage, the first stage relies wholly on chance). This will not be the case where a process requires participants to *exercise skill or judgment or to display knowledge*, and this requirement can be reasonably expected to prevent either (i) a significant proportion of people who wish to participate from doing so; or (ii) a significant proportion of people who participate from receiving a prize.

If the promotion satisfies this skill threshold, it is irrelevant whether or not payment is required to enter.

However, note that if the questions or tasks set are so easy as to be achievable by virtually everyone who enters, then there is a risk that the competition will be classified as a lottery and will not be permitted.

The CAP code sets out rules for sales and prize promotions that we advise all businesses to comply with. The CAP code requires that consumers are provided with certain information including: how to participate, the conditions, the cost, the organizer’s business address, a closing date, the prizes available, and any restrictions that may influence a participant's decision about or understanding of the promotion.

Charitable Promotions

Charitable promotions are regulated by the Charities Act 1992, which enforces certain prescribed requirements.

While there are no express reporting or registration requirements under UK charities legislation, the commercial entity wishing to raise money for a charity or charitable purpose (the "commercial participator") must ensure that it fulfills the Charities Act 1992 requirements, including:

i. entering into a written agreement with the charitable institution, setting out the terms of the arrangement (which are prescribed in the Charitable Institutions (Fund-Raising) Regulations 1994);
ii. ensuring that all communications to the public relating to the charitable giving include a solicitation statement, which sets out the full name of the charity benefitting, and the "notifiable amount": i.e., either the actual amount to be donated or the method by which the amounts to be given to charity are to be calculated (e.g., the percentage of the price of each item);
iii. making its books and records available for inspection by the charity benefitting; and
iv. making the donations to the charity as soon as reasonably practicable after receipt but, in any event, within 28 days of receipt, or such other period as is agreed with the charity.

Failing to comply with the requirements in the Charities Act will put the commercial participator at risk of criminal sanctions. For example, failure to provide a solicitation statement with all representations made about charitable giving is a criminal offense, giving rise to a potential maximum fine of £500 per offense.

The Institute of Fundraising has developed a Code of Fundraising Practice, which offers self-regulatory guidelines that apply to these types of promotions.

B. Hong Kong/China

Hong Kong

Introduction

Hong Kong is one of the major free ports of the world in terms of tonnage of shipping, cargo handling and the number of passengers carried. The business-friendly environment means that there are relatively fewer regulations that restrict the conduct of, or act as barriers to trade for, businesses in the territory. Nevertheless, brand owners should be mindful of the existing and developing regulatory framework in Hong Kong, and ensure compliance with the laws and regulations to avoid potential liabilities.

Regulatory Compliance

The consumer goods and safety laws in Hong Kong impose general safety requirements on goods supplied to consumers. It is not mandatory for brand owners to conduct safety tests on products prior to supply in Hong Kong; the burden and requirement to ensure that the goods are safe is on the distributors. Nevertheless, brand owners should take all reasonable steps and exercise all due diligence to ensure the products distributed are safe: e.g., for clothing, attaching warning labels in both English and Chinese stating the dangers of drawstrings near the neck area; obtaining safety certificates from approved laboratories before putting toys up for sale; and displaying, as required by regulations, sufficient warnings regarding the use of electrical appliances, to avoid hazards such as fire.

In addition to consumer goods and safety laws and regulations, the Sale of Goods Ordinance and Control of Exemption Clauses Ordinance impose certain implied conditions and warranties as to the quality or fitness of a product. The law prohibits exclusion of these implied terms from standard form contracts.

Brand owners must also be wary of the new offenses created under the Hong Kong Trade Descriptions Ordinance, which can impact on the way they conduct their sales and marketing activities. The newly amended Trade Descriptions Ordinance makes it an offense to engage in any of the following unfair trading practices:

i. misleading omission – if the omission of material information causes an average consumer to make a transactional decision that he or she would not otherwise have made;
ii. aggressive commercial practices – if a practice significantly impairs an average consumer's freedom of choice or conduct through harassment, coercion or undue influence, and causes the making of a transactional decision that would not otherwise have been made;
iii. bait advertising – if there is advertising of products at a specified price but there are no reasonable grounds for believing that the trader will sell at that price;
iv. bait and switch – the issuing of an invitation to buy a product at a specified price when, in fact, it was always intended for the promotion of a different product; and
v. wrongly accepting payment –accepting payment for a product without intending to supply the promised goods.

In relation to operating promotional competitions and games, the Gambling Ordinance makes it illegal to conduct gaming activities unless authorised by the relevant authorities. Gaming activities include raffles, sweepstakes, and competitions for money involving guesses or estimates of results of future events that do not depend on the skill of the competitor to a substantial degree. Brand owners should be cautious when operating promotional competitions and games not to fall under the definition of lottery or risk, and so commit an offense under Hong Kong law.

Future Developments

Hong Kong recently passed its new competition law, which seeks to prohibit conduct that prevents, restricts or distorts competition in Hong Kong, and to prohibit abuse of substantial market power. Guidelines on the implementation of the law and enforcement practices are under public consultation and are expected to be finalised at the beginning of 2015.

There are also pending proposals under the Copyright (Amendment) Bill 2011 to amend the Copyright Ordinance by introducing a statutory notice and takedown to address online infringement, among other things. These proposals are currently under legislative review and public consultation. The timetable for the enactment of the new law is unclear. In the meantime, brand owners can address online infringement by sending standard notice and takedown demands to online service providers, on the basis of potential primary and/or joint infringement liability.

Other Risks to Brand Owners

A shadow company is a limited company registered in Hong Kong that adopts a well-known brand name or trademark as part of its name. These companies are frequently registered by unscrupulous parties, and used to conduct and facilitate infringing activities; in particular, by misleading consumers in China as to their relationship to brand owners.

Brand owners are advised to conduct periodic searches of the Hong Kong Companies Registry to identify infringing targets and take action either by: (i) filing with the Companies Registry an administrative complaint against the company within 12 months of their incorporation; or (ii) taking civil trademark infringement action against them.

The Companies Registry has the power to direct and change a shadow company's name if it believes the shadow company's name is too similar to an existing registered company name. The Companies Registry can also do this pursuant to a court order directing the company to effect a name change based on the infringement of trademark.

Conclusion

Hong Kong provides many opportunities for brand owners, given its status in the world of trade. Despite being relatively less regulated, it is still best that brand owners conduct a thorough compliance review of Hong Kong's local legal requirements and regulations before entering the region, to avoid any unforeseen liabilities.

China (the Mainland)

Introduction

Brand owners should be mindful of the differences between China's trademark law and the trademark law in their home countries, especially those concerning the use of the registered trademark symbol and the statement that a mark is well known. China also has comprehensive national standards that may apply to fashion and luxury goods, such as compulsory standards for product safety and labeling. When engaging in e-commerce, brand owners should be aware of the specific regulations applicable to different e-commerce channels and the resulting pros and cons of using each e-commerce channel. Recent trends also demonstrate the Chinese authorities' increased scrutiny of business activities to identify anti-competitive effects.

Use of Trademarks

In China, the registered trademark symbol (®) can be used only if the brand owner has a valid trademark registration covering the specific goods or services on which the symbol is used. As an example, a brand owner of fashion or luxury goods should, in practice, ensure it has a valid registration for use of its trademark on accessories, such as sunglasses, jewelry and umbrellas, before using the registered trademark symbol on these goods. For commercial reasons, a brand owner might have only registered its trademark for primary goods, such as in classes that cover apparel and handbags. Although use of unregistered trademarks is permitted in China, brand owners should not use the registered trademark symbol unless a valid registration has been obtained for the goods at issue.

Brand owners should also be cautious when using the trademark symbol (™), as the legality of doing so is currently unclear. Some local trademark authorities consider the trademark symbol equivalent to the registered trademark symbol. Therefore, in some areas, the administrative authorities may challenge the use of the trademark symbol, unless the trademark is registered for use on the class of goods and used as registered.

China recently revised its Trademark Law. Under the revised law, effective 1 May 2014, brand owners are prohibited from identifying their trademarks as a "well-known mark" when advertising or conducting other commercial activities. The rationale behind this prohibition is to return the concept of well-known status to its original and only legitimate purpose, which is to grant protection of a well-known mark to technically dissimilar goods/services in trademark prosecution and enforcement matters.

Enterprising brand owners had been appropriating the concept of well-known status, and using its designation to serve as proof of the quality of their goods and to mislead potential consumers into believing the goods were recommended by Chinese authorities. To stop this practice and prevent potential consumer confusion, the revised Trademark Law prohibits making claims about well-known status when advertising or conducting other commercial activities.

Regulatory Compliance

In China, the manufacture, distribution and sale of fashion and luxury goods are subject to various types of government regulations. Consumer goods must comply with national standards that set benchmarks for the quality, safety, labeling, etc., of products. For example, Chinese-language labels are generally required for consumer goods distributed and sold in China.

Besides national standards, consumer goods are subject to regulations issued by administrative authorities. The General Administration of Quality Supervision, Inspection and Quarantine of China oversees the manufacture and importation of consumer goods. Specific goods, such as cosmetics, are regulated by the China Food and Drug Administration. When engaging in distribution, advertising and marketing activities, brand owners should also be mindful of relevant regulations of the State Administration for Industry and Commerce.

If a brand owner wants to distribute its products over the internet, it can do so through stand-alone websites or third-party trading platforms. Online sales activities are regulated by the State Administration for Industry and Commerce, which recently published *Administrative Measures for Online Sale of Merchandise*. To set up stand-alone websites, brand owners should also ensure that the websites comply with applicable regulations issued by the Ministry of Industry and Information Technology, such as obtaining a recordal as an Internet Information Provider of the stand-alone website.

In addition, Chinese authorities have taken a hard-line approach to anti-competitive measures. When entering into distribution or franchise agreements with local entities, brand owners should ensure that the agreements do not contain provisions that could be interpreted as anti-competitive, such as a minimum resale price or division of sale regions.

Takedown Requests on Alibaba and Taobao/Tmall

The most popular trading platforms in China are Taobao and Tmall, both of which are operated by the Alibaba group. Taobao purports to be primarily a C2C platform, while Tmall is designed as a B2C platform, targeting primarily institutional sellers. Many brand owners will opt to open an official store on Tmall, so as to gain access to the internal personnel of Alibaba. Taobao is notoriously uncooperative with takedown requests, but, in practice, brand owners have noticed that Alibaba is more likely to assist with the brand owner's enforcement efforts if it has an official store hosted on Tmall, including enforcing takedown requests against goods that Taobao has no clear statutory obligation to remove, such as parallel imports or other goods in the gray market.

In order to take down infringing listings from Alibaba and Taobao/Tmall, a brand owner will first need to open an account on their online intellectual property rights (IPR) protection system. It is said that both systems are operated by the same group of people, and the systems will eventually be merged into one.

The takedown mechanism on Alibaba and Taobao/Tmall are almost the same. Taobao/Tmall require all first-time complainants to verify their identity and the intellectual property rights on which the takedown notice is based. Taobao will only review the proof of IPR ownership after it has reviewed and accepted the identity documents.

After the IPR documents are accepted, Taobao will then review the takedown requests. If it deems that the listing at issue infringes the brand owner's IP rights, it will take the listing down and send a notice to the vendor. The vendor will have the opportunity to respond and justify the listing as legitimate: e.g., by showing that the goods were purchased from legitimate sources.

If Taobao refuses to take down the listings, the only remedy currently available to brand owners is to commence civil action in the People's Courts. However, civil action is often expensive and time-consuming.

In practice, it is usually difficult to demonstrate to Alibaba and Taobao/Tmall that the listings at issue are, indeed, infringing. For example, if the price difference between genuine goods and the listed goods is significant, would such a price difference be considered sufficient evidence? In another example, if the brand owner has never licensed the trademark on the type of the goods at issue, would such statement by itself be sufficient to convince Taobao? Consistent practice or clear guidance in this regard has not yet been established.

Various news outlets have reported that Alibaba has entered into agreements with some brand owners, under which the brand owners are to open official online shops on Tmall and receive stronger IP protection against infringing listings on Taobao. However, it is unclear how brand owners can start negotiating an official store with a stronger intellectual property protection mechanism.

Joint Liability of Third Parties

Currently, regulation of online trademark infringements (unlike online copyright infringement or online defamation, etc.) has not fully developed in China. Brand owners largely rely on the general liabilities for infringements under the People's Republic of China (PRC) Trademark Law. One recent development is joint liability under the PRC Torts Law, as supplemented by the Administrative Measures for Online Trading.

Article 36 of the PRC Torts Law provides that internet users and internet service providers shall bear tortious liability in the event they infringe other people's civil rights and interests through the internet. The injured party can request the internet service provider remove the content. If the internet service provider fails to take the necessary action, it will be jointly and severally liable with the internet user that caused the damage. The same liability is also applied if the internet service provider knows that an internet user is infringing other people's rights but fails to take any necessary action.

Article 27 of the Administrative Measures for Online Trading provides that operators of the third-party trading platform must take the necessary measures to protect intellectual property rights in accordance with the PRC Torts Law. This is applicable as long as there is evidence that the operator is involved in the acts violating intellectual property rights or breaches any unfair competition provisions.

In practice, the primary difficulty is to define "necessary" measures or actions. Courts tend to require the infringement to be repetitive and blatant in order to hold the internet service provider or third-party trading platform (such as Taobao) liable for the infringement.

Conclusion

China, like many Asia-Pacific countries, has specific legal requirements and a unique regulatory system. Before entering the Chinese market, or any other market in the Asia-Pacific region, brand owners should conduct a thorough compliance review of the local legal requirements and regulatory system.

Russia

Wholesale Sales, including to Department Stores

The generally accepted market practice in Russia is to have a long-term commitment for goods delivery for wholesale purposes. Such commitment is generally reflected in a framework agreement for purchase and sale between the brand and a local distributor or department store. At the same time, the particular goods deliveries are agreed based on purchase orders. Consequently, without a firm commitment for minimum purchase volumes, a distribution agreement may be effectively terminated or suspended by a buyer refusing to submit and/or agree to the terms of the purchase order.

Under Russian law, it is impossible to limit the liability of the seller and/or manufacturer toward a consumer. For example, it is prohibited to limit or exclude a liability related to actual performance – the so-called "make good" obligation. For this reason, Russian distributors always push for full compensation of any consumer claims and related costs. Under Russian law, a consumer, at his or her sole discretion, may claim one of the following remedies from the seller of defective goods:

i. replacement of the defective goods with a new product of the same type, brand and/or index;
ii. replacement of the defective goods with new goods of another type, brand and/or index, and settlement of the price difference between the replaced goods and the new;
iii. proportionate decrease of the purchase price;

iv. immediate gratuitous repair of the defective goods or compensation of the consumer's costs incurred repairing the goods' defects;
v. termination of the purchase agreement and refund of the purchase price. At the seller's request and expense, the consumer has to return the defective goods to the seller.

In addition to the above remedies, a consumer is entitled to claim compensation for his or her losses incurred due to the purchase of the defective goods.

Importantly, under Russian law a consumer may file the claims indicated in points "a" and "d" above directly against the manufacturer of the defective goods. Instead of addressing these claims to the manufacturer, a consumer may also return the defective goods to the manufacturer and claim a refund of the purchase price paid for such goods.

A consumer may address the above claims to the manufacturer and the seller of the defective goods (as applicable) within the warranty period established by the manufacturer and the seller (as applicable). If the warranty period is not established by the manufacturer and the seller, then the consumer may file the relevant claims within two years after the defective product is delivered to the consumer.

If the warranty period established by the manufacturer and the seller is less than two years, a consumer may still file the above claims within two years after the defective goods are delivered to the consumer, provided that the consumer proves the relevant defects occurred prior to the delivery of the goods to the consumer or are due to reasons that occurred prior to such delivery.

Moreover, the consumer may is entitled to claim from the manufacturer free removal of defects within the service life of the goods or, if the service life is not stated, within 10 years after the delivery of the goods to the consumer. If such a claim is not met within 20 days from the moment of its receipt, then the consumer is entitled to file claims provided by points "a" and "d" above, or return the defective goods to the manufacturer and claim a refund of the purchase price paid for such goods.

As indicated above, under Russian law it is not possible to limit the manufacturer's and/or seller's liability to a consumer under the contract. At the same time, there is a market practice of limiting the manufacturer's/seller's liability for goods by definition of the goods' qualities, terms of use and applicable limitations in using the goods. The limitations excluding liability for the intended purpose of the goods might be considered by Russian courts to be invalid unless the seller makes it explicitly clear in the contract that the relevant intended purpose is not applicable and the product serves other purposes.

Russian law requires that the seller explicitly states any limitations of the intended purpose and specific terms of use prior to entering into a contract with a consumer. Therefore, it is recommended this tool be used with discretion, since it may affect the reputation of both the manufacturer and the seller, as well as their brands.

Branded Corners/Shop-in-shops

This is a popular arrangement in the Russian market. Depending on the content and complexity of the particular brand requirements, the brand may propose its distributor(s) enter into a distribution (supply/service) agreement or a trademark license/franchise agreement. The difference between the two options mainly depends on whether any intellectual property rights are granted to a local distributor.

Under a general rule of Russian law, any third party may use a trademark only with the trademark owner's consent, which is, as a rule, granted under a trademark license or franchise agreement. The grant of rights to use a trademark under such an agreement is subject to mandatory state registration with the Russian Patent and Trademark Office (Rospatent). However, no trademark owner's consent is necessary if the goods under a trademark have been introduced into commerce in Russia by the trademark owner or with its consent.

Consequently, as a matter of Russian law, the rights to the trademarks would be considered exhausted in Russia at the moment the trademark owner or its authorized licensee sells the goods to a distributor and such goods are imported into Russia.

While it is generally accepted that the above consent may be granted under certain conditions related to brand protection, in most cases such conditions fall under the scope of the trademark (service mark) license or franchise agreement.[2]

Licensed Departments/Concessions

This concept is almost non-existent in Russian market practice. Generally, the relations between the brand and the department store (or the premises owner) are limited to lease and related arrangements.

Directly Owned Mono-brand Stores and Factory Outlets

While originally this model was used mainly by high-end and luxury brands, currently this trend is also followed by other segments of the industry, which initially entered the market through local distributors. One of the reasons why brands are willing to take over their local distributors is that, under Russian law, distributors are not entitled to compensation after the termination (or expiry) of the distribution/commercial agency arrangement (as required, e.g., under the EU Council Directive On Commercial Agents).

Franchise

The concept of franchising has been recognized from the mid-1990s, when Russia adopted its first franchise legislation as part of its Civil Code. Most recently, amendments were introduced to the franchise law and became effective as of 1 October 2014.

Under Russian law, by means of a franchise agreement the franchisor grants to the franchisee a set of exclusive rights (i.e., the rights with regard to intellectual property) that include the rights in a trademark, service mark, as well as other intellectual property, such as trade name and know-how, business reputation and commercial experience, which rights shall be used by the franchisee in its business for a specified or unspecified period in return for the payment of a fee to the franchisor.

Franchise agreements, being complex arrangements that combine intellectual property licenses with other types of contracts, are subject to numerous limitations and requirements. In the past, Russian franchise law tended to be more franchisee-friendly. However, as a result of recent legislative changes, it became more balanced, in terms of providing comparable protection to both parties.

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[2] See franchise section below.

The franchise agreement between an international franchisor and a Russian franchisee may be governed by non-Russian law. However, certain mandatory Russian law provisions would be applicable to the franchise arrangements irrespective of the parties' choice of law.

Liability Under Franchise Agreement

Under Russian law, a franchisor is vicariously, or even jointly and severally, liable with a franchisee regarding claims brought against the franchisee in respect of the quality of franchised goods and/or services. The scope of such liability differs depending on whether or not the franchisee manufactures under the franchise agreement those goods in connection with which a claim is brought.

Renewal Right

In accordance with the Russian Civil Code, upon expiry of a franchise agreement a franchisee that has duly performed its obligations under the expired agreement has a preemptive right to renew the franchise agreement for a new term.

If the franchisor refuses to renew the franchise agreement with the initial franchisee for a new term, but *within one year* from the expiration of the initial franchise agreement the franchisor enters into a franchise agreement with another franchisee, under which new agreement the new franchisee is granted the same rights as were provided to the initial franchisee under the expired agreement, and on the same terms and conditions, the initial franchisee will be entitled to claim in court, at its discretion: (1) transfer of rights and obligations under the newly concluded agreement to the initial franchisee, and compensation of damages caused by the franchisor's refusal to renew the franchise agreement with the initial franchisee for a new term; or (2) just compensation of damages.

Registration Requirements

Until recently, Russian law required that a franchise agreement be registered with Rospatent in order to be valid, effective and enforceable in Russia.

Starting from 1 October 2014, new registration requirements for franchise agreements came into effect. A mandatory requirement to have a franchise agreement registered with Rospatent has been replaced by a mandatory requirement to register with Rospatent a grant of right to use intellectual property under a franchise agreement. If such a requirement is not met, the grant of the right to use intellectual property would be considered invalid. At the moment, it is not precisely clear how new registration regulations would actually work. It is anticipated that there will be some ambiguity in implementation and enforceability of those franchise agreements, or parts of franchise agreements or amendments thereto, that are not submitted to and registered with Rospatent.

E-commerce

<u>*Entering into an Agreement with a Customer*</u>

Both "clickwrap" and "browsewrap" types of agreements are widely used in the Russian market. While these type of agreements are not specifically mentioned under Russian law, it is generally accepted that they represent a mechanics of entering into a contract by way of exchanging "offer" and "acceptance" or, in some cases, "exchange of documents through electronic means".

These mechanics are recognized under Russian law only if they allow conclusive identification of the recipient and the sender of the documents (or offer and acceptance, as applicable). In practice, this condition is satisfied through the following requirements provided in the online shop terms and conditions: (1) the buyer must create a personal account on the online shop website; and (2) the buyer must pay for the goods using his or her own credit/debit card.

An electronic signature under Russian law is an "e-key" issued by a Russian-certified center, included in the register kept by the Russian Ministry of Communications. Since most internet selling platforms do not use such certified keys, when a customer is required to certify the purchase with his or her e-signature or password, it would likely be treated as entering into an agreement by way of exchanging "offer" and "acceptance" or "exchange of documents through electronic means".

Cross-border Sales to Consumers

Cross-border sales directly to Russian consumers give rise to various complexities, making such arrangements impractical. For example:

i. Russian consumers are required to declare the products submitted for customs clearance, unless the delivery meets certain price and weight thresholds (up to 1000 euros[3] and 31 kilograms) and is made through the Russian Post, which, as a member of the Universal Postal Union, is entitled to declare products on consumers' behalf through a simplified application. In practice, the Russian Post submits such an application as part of its postal service, and the consumer is not required to perform any additional actions. Any inconsistency in the invoice, product's packaging or other information submitted to Russian customs might lead to customs requesting additional information from the Russian consumer and his or her active involvement in the customs clearance process. In practice, Russian customers may face delays in delivery of parcels imported via the Russian Post.

ii. Russian consumers are required to pay customs duties on any imported order exceeding 1000 euros[4] and weighing over 31 kilograms. Please note that, in addition to this, individuals might be required to present special permission documents (e.g., approval for import, confirmation of the Federal Security Council notification, etc.) issued by the relevant government bodies with respect to specific products listed in the law: e.g., encryption-based or radio-frequency transmitters, ozone-destroying aerosols.

Privacy

Starting from 1 September 2016, transfer of Russian citizens' personal data outside Russia is allowed only with the use of databases located in Russia. In particular, online shops would have to collect, systemize, maintain, update, change and retrieve personal data with the use of databases located in Russia.

[3] Currently, the Russian government is discussing the option of lowering the limit to 150 euros.
[4] Currently, the Russian government is discussing the option of lowering the limit to 150 euros.

Promotions

Russian regulations related to sweepstakes and contests do not contain a lot of mandatory requirements for the organizers.[5] Both Russian and non-Russian entities may organize a promotion in Russia. Even if a non-Russian entity runs a promotion, Russian consumer protection and privacy regulations apply. The main requirements address the transparency of the promotion terms, local language requirements, and the obligation to provide the prize to individuals who perform the actions required of the winner or who are chosen as such under the terms of the promotion.

Starting from January 1, 2014, games of chance arranged by private companies were carved out from the lottery regulations and no longer are subject to registration with the Russian authorities. At the same time, lotteries became a state monopoly.

[5] We do not comment here on types of promotion that, in substance, represent gambling, which is subject to strict licensing requirements in Russia.

Chapter 6: Tax Issues for the Luxury and Fashion Industry[1]

I. Introduction

The luxury and fashion industry faces a similar set of tax, transfer pricing, tax compliance and tax controversy issues as most other industries. It is not the intent of this chapter to enumerate all of these issues as that, in many respects, would repeat the obvious. Yet, the luxury and fashion industry does have its unique characteristics and issues, particularly in transfer pricing disputes, and items of intellectual property such as trademarks, brand equity and marketing intangibles. Many of today's tax, transfer pricing and tax controversies surround these items of intellectual property and the business models that are created to develop and exploit them. A discussed below, these issues have been intensified with the recent sound bites from the press regarding the initiatives of the Organization for Economic Cooperation and Development (OECD)[2] involving the perceived base erosion and profit shifting (BEPS) efforts of some multinational enterprises.

A. Overview of Tax Issues impacting the Industry

1. Transfer Pricing Tax Controversy

The luxury and fashion industry is facing increasingly aggressive tax audits worldwide. A critical focus of these audits has been the transfer pricing policies and practices of the multinational enterprises (MNE) in this industry. Transfer pricing, an increasingly important and contentious area of tax law in the United States and around the world, deals with the pricing for intercompany transactions within the MNE's group. In the United States, as well as most developed countries, tax authorities have adopted detailed sets of rules and regulations (including documentation requirements) to determine an entity's taxable income, when that entity engages in "controlled" transactions with related entities. Further, the OECD has issued transfer pricing guidelines to implement these rules and to fill gaps where the rules in certain countries are not complete. In addition, the OECD has its own set of guidelines on country by country documentation requirements, (e.g., CbC reporting), which have recently been further updated in light of its BEPS project.[3] As MNEs continue to expand into foreign markets, and their businesses evolve, tax authorities have gained greater appreciation for the tax revenues at stake and have

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[2] Organization for Economic Cooperation and Development.
[3] CITE OECD Guidelines for Multinational Enterprises and Tax Administrations.

heightened transfer pricing tax enforcement.[4] The OECD's BEPS initiative has exacerbated these controversies because transfer pricing adjustments and assessed penalties typically involve significant monetary amounts. In the United States, transfer pricing is the single largest tax issue for all foreign-based and US-based MNEs, as well as the issue most impacting MNEs' financial statements. Thus, determining the true taxable income of related entities has been increasingly important and, at times, most challenging.

The consensus among most countries is that the profit earned by a MNE on its intercompany transactions must be equivalent to the profits that it would have realized in a comparable transaction with an independent enterprise, otherwise known as the "arm's-length" standard.[5] At first glance, the application of this requirement may seem straightforward. However, establishing under this standard robust and reliable transfer pricing policies that withstand audits can be challenging and requires a critical and thorough analysis.

The arm's-length standard is not necessarily an absolute concept, and the intercompany allocation of profits maintained by MNEs are susceptible to worldwide transfer pricing disputes that give rise to audits and, often, international double taxation. Controversies arise when tax authorities in multiple jurisdictions engage in a tug of war to attribute income from an MNE's global – supply-chain profits to their respective jurisdictions, based on the functions, risks, and assets arguably utilized in that country.

2. Marketing Intangibles

A prominent issue that tax authorities frequently raise in the luxury and fashion industry is the development, transfer and use of intangibles, most notably "marketing intangibles". Although there is no precise definition for "marketing intangibles", it typically includes various items of marketing and promotion of the firm's tradename, trademarks and tradedress, logos and know-how that surrounds a trademark to promote the brand image. These items can include the knowledge of distribution channels, customer relationships and marketing know-how.[6] If tax authorities are attempting to refute that international entities are developing valuable marketing intangibles, they may take the position that investment in these intangibles is simply indicative of a company's routine level of advertising, marketing and promotion expenditures (AMP) within a jurisdiction. On the other hand, if tax authorities take the position that a local subsidiary is developing marketing intangibles for which the parent company should be responsible, they may attempt to assert that the parent company should reimburse the local affiliate for those expenses, perhaps even with a markup.

Among the most significant issues in marketing intangible controversies is the juxtaposition between the legal owner of a trademark and the economic costs incurred by a local affiliate to promote and exploit the trademark in its territory. Tax authorities may look to the bifurcation of trademark value between the legal and beneficial owner, and measure it through the amount of

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[4] In August 2010, the announced realignment. In October of 2010, the U.S. Internal Revenue Service ("IRS") completed realignment of the Large and Mid-Size Business ("LMSB") division to create a more centralized organization dedicated to improving international tax compliance. LMSB was thereafter renamed Large Business and International ("LB&I"). http://www.irs.gov/newsroom/article/0,,id=226284,00.html

[5] Although many countries have adopted the arm's-length standard, some countries, including most states within the United States, use a formulary approach to allocate income between related entities.

[6] But indeed do not include the trademark's' quality control and goodwill that are inseparable from the actual trademark.

brand-building expenses incurred by each party (although the tax authorities typically rely on the AMP without regard to whether it is in total a brand-building expense). In their quest to identify the beneficial owner of an intangible (and hence generate taxable revenue through the activities of the owner) tax authorities often question the role of local country marketing groups versus that of the legal brand owner. Some key elements at play here include: flagship stores and their role in generating brand value and contributing to the overall global brand, internal marketing subsidies, celebrity contracts, advertising campaigns, exchanges of know-how, etc.

The allocation of marketing intangible value often turns on the functional and contractual arrangement set between the parent entity and the local retail/distribution affiliate. A local affiliate who has (by contract) agreed to be structured as a limited risk distributor (LRD), should have limited decision-making powers and operate at the sole direction of the parent entity. A LRD therefore generally does not develop, own, or control intangibles, and is not expected to bear the costs and risks associated with brand-building expenses.[7] In these cases, tax authorities expect the parent entity to reimburse the LRD (in the form of a marketing or sales support payments, or reduced transfer prices) to cover all non-routine brand-building marketing expenses, including relevant parts of the AMP that it may incur.

On the other hand, "full-risk" distributors operate in a manner analogous to entrepreneurs and may assume expenses relating to AMP and the operation of flagship stores to promote the brand. The distributor in this case should be (economically and legally) entitled to any marketing intangibles developed as a result of its efforts, which may be reflected in a long-form license or distribute against, fixed gross margin pricing or some other situation that allows for it to have the opportunity to realize the benefits from its investment. Difficulty often arises when tax authorities and taxpayers disagree on the contractual terms between the parties, particularly where these terms do not align with the actual functions performed by the MNE, or where the nature and type of expenses incurred by an entity are construed as actual brand-building expenses. Of course, vague and ambiguous contractual terms leave this issue to be determined by tax authorities based on, and their perceptions of, the taxpayer's behavior.

This chapter will provide an overview of transfer pricing rules as pertaining to companies in the luxury and fashion industry, followed by a discussion of most prominent issues that give rise to tax audits and controversies. This chapter will also provide various alternative avenues for taxpayers to reduce the cost and time associated with tax and transfer pricing audits.

II. Transfer Pricing Rules and Practices

A. Overview of Transfer Pricing Principles and Rules

The statutory objective of transfer pricing is to prevent tax evasion and ensure that taxpayers clearly reflect income relating to transactions between controlled entities. In the United States, principles are set forth in section 482 of the Internal Revenue Code of 1986, as amended, ("IRC"), and implemented in the Regulations promulgated thereunder (Regulations). Similarly, many countries throughout the world have adopted transfer pricing guidelines issued by the OECD (the

[7] In the civil jurisdictions of the EU, commissionaire structures are frequently used as LRDs. While commissionaires have unique characteristics, for transfer pricing purposes they are akin to LRDs.

OECD Guidelines), which, like the US rules, follow the arm's-length standard. Without these policies and regulations, taxing authorities would have limited ability to prevent MNEs from artificially shifting taxable income into lower-tax rate jurisdictions through intercompany pricing.

Section 482 authorizes the Internal Revenue Service, ("IRS") to allocate gross income and other items (deductions, credits, allowances, basis, etc.) between commonly controlled (i.e., related) entities if necessary to prevent tax avoidance or to reflect clearly the entities' income attributable to controlled transactions. The true taxable income earned through intercompany transactions is determined by placing a controlled taxpayer on parity with an uncontrolled (i.e., independent) taxpayer. This objective is achieved by testing whether the transactions between related parties (for tax purposes) are conducted at arm's length.

The arm's-length standard states that the amount charged by one related party to another for a given transaction must be equivalent to the amount charged had the parties been unrelated. An arm's-length price for a transaction is therefore what the price of that transaction would be in the open market. Controlled transactions are generally evaluated with reference to the profit/price realized in comparable transactions under comparable circumstances.

To identify reliably comparable transactions, an analysis is conducted to review the economically relevant characteristics of the transactions being compared and determine whether the differences (if any) between the transactions could materially affect the price of the transaction. This warrants a careful consideration of all economic conditions of the controlled and uncontrolled transactions, such as characteristics of the property or services transferred, the functions performed by the parties (including assets, property and equipment used and risks assumed), the contractual terms, the economic circumstances of the parties, and the business strategies pursued by the parties.

Consistent with the arm's-length standard and its comparability factors, both the Regulations under section 482 and the OECD Guidelines set forth methods for benchmarking intercompany pricing for tangible and intangible transfers of property, as well as the provision of services. These Regulations do not include an ordering rule for priority of methods, but, rather, the selection of the appropriate method is subject to a "best method" rule that seeks a method most appropriate based on the facts and circumstances of the taxpayer, and also will allow for the most ascertainable and reliable economic or empirical benchmarking data. These methods, in the context of section 482, are summarized below.[8]

1. Tangible Property

The Regulations provide six specified methods for determining the arm's-length price in a controlled transfer of tangible property. These methods are generally broken down into transaction methods and profit-based methods. The latter could be a determination of an allocation of system profit among the relevant entities or simply a transfer price to target a certain profit or range of profits. The six methods are listed below.

<u>Comparable Uncontrolled Price (CUP) Method</u>. This is a traditional transaction method. Under the CUP method, an arm's-length price for a controlled sale of tangible property is equal to

[8] It should be noted that, at this time, the methods cited in OECD Guidelines are generally analogous to those in the Regulations.

the price paid in a comparable uncontrolled transaction. The Regulations provide that the CUP method will generally provide the most direct and reliable measure of an arm's-length price if (i) no differences exist between the comparable uncontrolled transaction and the controlled transaction that would affect the price; or (ii) only minor differences (that have a definite and reasonable ascertainable effect on price) exist and appropriate adjustments are made. Thus, where an entity sells a product to a related party, and also sells the same product under substantially similar circumstances to a third party, an "internal CUP" exists. To the extent there are reasonably measurable differences, adjustments can be made. Internal CUPs may exist in the luxury and fashion industry if, for example, the company has franchises or third-party licenses that can be reliably compared to the intercompany transaction being evaluated. "External CUPs" (i.e., agreements that are not affiliated with or controlled by the MNE) may be found in publicly available databases, although these cases tend to be rare.

Resale Price Method (RPM). The RPM is also a traditional transaction method and most typically focuses on the gross margin of a controlled sales company that performs marketing and selling functions for its related parties. The RPM evaluates whether the amount charged in a controlled transaction is arm's length by reference to the gross margin realized in comparable uncontrolled transactions. The RPM measures the value of functions performed, risks assumed and assets employed where a company purchases and resells tangible property without adding substantial value to the property or physically altering the goods. Generally, packaging, labeling, or minor assembly do not ordinarily constitute physical alterations for the purposes of this method. However, the RPM generally is not applicable if the tested party adds substantial value to the property through the use of its intangible property.

Where possible, gross margins should be obtained from comparable uncontrolled purchases and re-sales of the reseller involved in the controlled sale. More common in the fashion and luxury setting is a comparison of the gross margins of comparable uncontrolled sales from the seller to third parties. Otherwise, the arm's-length gross margin comparison can be derived from publicly available data on independent uncontrolled distributing companies. Gross margin compensates the reseller for the performance of resale functions, including the reseller's capital investment and assumption of risks. Accordingly, product similarity is not as critical as functional similarity between the controlled and uncontrolled transactions.

Cost Plus Method. The cost plus method, also a transaction-based method, determines an arm's-length price by reference to the gross margin markup realized in comparable uncontrolled transactions. The cost plus method is ordinarily used in the manufacture, assembly or production of goods that are sold to related parties. Under this method, an arm's-length price is determined by adding to the direct cost of producing property, a profit markup or the appropriate gross profit percentage (expressed as a percentage of cost) earned by the controlled seller or another party in comparable uncontrolled transactions. However, because it may be difficult to argue which costs are reflected in the gross margin and operating expenses of comparable companies, it may be difficult to apply the cost plus method, and applying the Comparable Profits Method ("CPM") with a return on total costs as the profit level indicator ("PLI") may be more appropriate depending on the circumstances.

Unlike the RPM that typically focuses on the distributor, cost plus method largely focuses on the related manufacturing company as the tested party in the transfer pricing analysis. The gross profit of the producer compensates the producer for the performance of manufacturing functions, as well as operating profit for its capital investment and assumption of risk.

CPM. The CPM, which is a profit-based method, is one of the most commonly used transfer pricing methods. It is generally based on objective measures of profitability obtained from uncontrolled taxpayers that engage in business activities similar to the business activities of the controlled taxpayer. In order to determine whether the amount charged in a controlled transaction is arm's length, more specifically, the controlled entity's profitability (calculated as a ratio of profit over sales, assets or costs, known as 'profit level indicator') is compared to the PLI of comparable companies engaged in uncontrolled transactions. This PLI is typically calculated using the financials of publicly traded companies with readily available data. In applying the CPM, functional similarity is paramount, while substantial product similarity is less important.

Profit Split. The profit split method is typically evaluated under either the comparable profit split method or residual profit method.

- Comparable Profit Split Method. Under the comparable profit split method, the combined profit or loss of the controlled taxpayers is allocated by reference to the division of the combined profits or losses of uncontrolled taxpayers.
- Residual Profit Split Method. This method provides a two-step allocation procedure for dividing combined profits among the parties to a controlled transaction. The procedure allows each controlled party a rate of return for the routine economic functions that they perform. Any residual combined profit is deemed attributable to non-routine intangibles, and allocated among the controlled parties based on the relative value of the intangibles they have contributed to the combined enterprise.

Unspecified Methods. A method other than those specifically described under the Regulations may be used to determine whether the amount charged in a controlled transfer of tangible property is arm's length only if it provides the most reliable measure of an arm's-length result under the best method rule, and the taxpayer shows that none of the specified methods would be more reliable in benchmarking the controlled transaction.

2. Intangible Property

The Regulations provide the following four methods for determining the arm's-length charge in a controlled transfer of intangible property:

Comparable Uncontrolled Transaction Method (CUT). Under the CUT method, an arm's-length consideration for a controlled transfer is determined by reference to a comparable uncontrolled transaction involving comparable intangible property and comparable circumstances. This is the analog to the CUP method for tangible property.

Comparable Profits Method (CPM). The application of this method for items of intangible property tracks the application of the CPM for tangible property transfers.

Profit Split Methods (Comparable and Residual Profit Methods). The application of these methods for items of intangible property tracks the application of these methods for tangible property transfers.

Unspecified Methods. As with tangible transfers of property, a method other than those specifically described under the Regulations may be used, but only if it provides the most reliable measure of an arm's-length result under the best method rule.

3. Services

When a group of controlled entities performs marketing, managerial, administrative, technical or other services for the benefit or on behalf of another member of the group, the provider of services generally must be compensated. Services typically include fees paid to distributors and commission agents, management services, general and administrative services, and technical assistance services.

Transactions involving the transfer or use of tangible or intangible property often are in conjunction with provision of services. In some transactions, these services facilitate the initial transfer of the intangible property. In other cases, the transfer of the property is accompanied by continuing technical services. In either situation, it may be important to determine whether an allocation or a charge constitutes a royalty for the transfer or use of the property or compensation for the related services.

The distinction between royalties and services is important for several reasons. The characterization would affect the recipient's foreign tax credit limitation, for example, because section 861 sets forth significantly different source rules for royalty income than it does for service income. In addition, the related licensee's deduction could be affected by the characterization, as could the rate of withholding tax imposed on the payment. The distinction is also important for section 482 purposes, because Regulation section 1.482-9(b), which applies to services, may require a different allocation than for intangibles.

Services rendered in connection with the transfer of property are not generally subject to a separate section 482 allocation, but rather should be considered part of the property transferred, and any allocation should be determined under the rules for the transfer of property. That is, the value of the services is considered to be "built into" the royalty, or the price of the goods.

Services are rendered in connection with the transfer of property when those services are "merely ancillary and subsidiary" to the transfer or the effective use of the property by the transferee. Whether services are merely ancillary or subsidiary is a question of fact and circumstances, although the Regulations do provide a few examples. Under the Regulations, services that could be ancillary or subsidiary to the transfer of tangible or intangible property include start-up assistance, such as demonstrating and explaining the use of the property, performance under a start-up guarantee, supervising integration of a new process into a manufacturing operation, and demonstrating and explaining the use of the property. It is important to note that continuing services rendered after the start-up or integration phase may be subject to a separate "services" allocation or charge.

The Regulations reference the following six specified methods that may be used to price intercompany services. The first three of these methods are generally analogous to the specified methods for transfer of tangible property (i.e., CUP, Resale Price and Cost Plus Methods). The CPM and profit split method follow the methods for pricing of tangible property, though they introduce concepts concerning the transfer of intangibles embedded in the services transaction.

<u>Comparable Uncontrolled Services Price (CUSP) method</u>. This method evaluates whether a controlled service transaction satisfies the arm's-length standard by comparing the price of the transaction with the price charged in comparable uncontrolled services transactions. It is analogous to the CUP method for tangible property transfers.

Gross Services Margin (GSM) Method. The GSM method evaluates the arm's-length price charged in a controlled service transaction by reference to the "gross services profit margin" realized in uncontrolled transactions involving similar services. It is analogous to the RPM method for tangible property transfers.

Cost of Services Plus Method. This method evaluates the arm's-length nature of the amount charged in a controlled service transaction by comparing the markup earned on gross margin services costs to the make up earned in comparable services transactions. It is analogous to the cost plus method for intangible property transfers.

Comparable Profits Method (CPM) for services. Similar to the discussion of the CPM for tangible goods, the CPM for services tests whether the service fee charged in a controlled service transaction is an arm's-length amount based on an analysis of objective measures of profitability (PLIs) derived from financial information regarding uncontrolled taxpayers that engage in comparable business activities under comparable circumstances.

Services Cost Method (SCM). The SCM provides a limited safe harbor for low-margin, intragroup back office services that meet certain quantitative or qualitative requirements to be changed at cost.

Profit Split Method. This method generally tests whether a controlled taxpayer's reported allocation of the combined pool of operating profit or loss generated by a controlled service transaction is at arm's length, based on the relative value of that taxpayer's contributions to the combined operating profit or loss pools.

4. Transfer Pricing Penalties

In many jurisdictions, taxpayers face stiff penalties for non-compliance with applicable transfer pricing rules. For example, in the United States, section 6662 authorizes the IRS to impose an accuracy-related penalty equal to 20 percent of the underpayment of tax attributable to: (1) negligence or disregard of rules and regulations; (2) substantial understatements of income tax; (3) substantial valuation misstatements (including transfer pricing misstatements) increased to 40 percent for "gross" valuation misstatements; and (4) certain other items. Section 6664(c) provides that no penalty will be imposed under section 6662 for an underpayment if there was "reasonable cause" for the underpayment and the taxpayer acted in "good faith" in computing its tax obligation.

The determination of whether a corporation acted with "reasonable cause" and good faith is based on the facts and circumstances of each case. To avoid substantial understatement penalties, at a minimum, the corporation must show that: (1) it had "substantial authority" for its treatment of the item; and (2) it reasonably believed, at the time it filed its return that its treatment was "more likely than not" the proper treatment. The taxpayer can satisfy the reasonable belief requirement by showing that it reasonably relied in good faith on the more likely than not opinion of a professional tax advisor.[9]

Section 6662(e) imposes a 20 percent penalty on the tax underpayment attributable to transfer pricing, but it is increased to 40 percent for adjustments over certain thresholds.[10] These penalties

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[9] Treas. Reg. § 1.6664-4(f)(2)(i)(B)(2).
[10] Section 6662(a), (b)(3), (e), (h).

can come in two forms: a “transitional” penalty or a “net adjustment” penalty, but not both. The 20 percent penalty applies if the price for any property or services or for the use of property claimed on a return is 200 percent or more or 50 percent or less of the correct price determined under section 482 (the “transactional penalty”).[11] The transactional penalty is increased to 40 percent if the return price is 400 percent or more or 25 percent or less of the correct price.[12] The 20 percent penalty also applies if the net section 482 adjustment is greater than the lesser of $5 million or 10 percent of gross receipts (the “net adjustment penalty”).[13] The net adjustment penalty is increased to 40 percent if the net section 482 adjustment is greater than the lesser of $20 million or 20 percent of gross receipts.[14]

A taxpayer will be deemed to satisfy the reasonable cost exception to avoid the net adjustment penalty only if the taxpayer: (1) establishes that it determined its transfer price in accordance with a transfer pricing method specified in the section 482 Regulations and its use of that method was reasonable; (2) has documentation in existence at the time of filing its return showing its determination of its transfer price using the specified method and establishing that its use of that method was reasonable; and (3) provides the documentation to the IRS within 30 days of request.[15]

In most cases, satisfaction of the section 6662(e) documentation requirement is the only way to avoid a section 6662(e) penalty. However, the taxpayer may still rely upon other reasonable cause exceptions such as advice of counsel to avoid application of the transactional penalty. This is the case in other taxing jurisdictions as well, where the preparation of documentation can reduce or eliminate penalties related to erroneous transfer pricing and/or reverse taxpayer burden of proof. Consequently, taxpayers routinely prepare transfer pricing documentation to satisfy local requirements and avoid penalties.

Transfer pricing documentation typically includes a detailed statement of the relevant facts regarding the taxpayer’s operations (a functional analysis), an overview of the taxpayer’s industry/market, a summary of the transfer pricing methods, an analysis of the potential application of the various transfer pricing methods to the taxpayer’s facts, a selection of the most reliable method (the best method) and a conclusion regarding the arm’s-length nature of the taxpayer’s transfer prices. Attorneys, certified public accountants or economists may prepare such documentation. The preparer may be an employee of the taxpayer or a member of an outside professional firm.

B. Comparability Analysis

In applying the arm’s-length standard, each transfer pricing method requires identifying comparable, independent transactions or companies in the market to benchmark the controlled transaction under review. A comparability analysis is critical to applying the arm’s-length principle. A comparability analysis entails reviewing the economically relevant characteristics of the controlled and uncontrolled transactions being compared, and determining whether the

[11] Section 6662(e)(1)(B)(i); Treas. Reg. § 1.6662-6(b)(1).
[12] Section 6662(h)(2)(A).
[13] Section 6662(e)(1)(B)(ii); Treas. Reg. § 1.6662-6(c)(2).
[14] Section 6662(h)(2)(A).
[15] Section 6662(e)(3)(B)(i); Treas. Reg. § 1.6662-6(d)(2).

differences (if any) between the situations being compared could materially affect the price of the transaction. In all situations, broad comparability (of transaction or companies) must be ensured from the beginning of the analysis, although the standards of comparability may differ depending on the selected method.

For example, under transaction-based methods such as the CUP method, because the objective is to compare the prices of products sold between related parties and products sold between unrelated parties, a high degree of product and transaction comparability is required. Product features, characteristics, brand/embedded IP, sales volume and shipping terms can all have significant impact on price, and therefore must be identical or substantially similar.

Under the profit-based methods, while functional comparability between the uncontrolled transaction and the tested party is crucial, product comparability is not required. Typically in an open market, companies that undertake greater, more complex functions, utilize more assets (including intangible assets), and face higher risks expect to earn higher returns in the long run. Therefore, in transactions between two independent parties, compensation usually will reflect the functions that each enterprise performs (taking into account assets used and risks assumed), characteristics of the property or services transferred, the contractual terms, the economic circumstances of the parties, and the business strategies pursued by the parties. Thus it is important to fully review and understand the scope and nature of the transactions and parties under review.

For example, in the context of the luxury and fashion industry, MNEs can expand their operations outside the United States by setting up various types of entities with different levels of functions and risks. An MNE has the option of (1) setting up a branch and directly operating in a foreign jurisdiction; or (2) creating subsidiaries (as commissionaires, limited risk or full fledged risk distributors) to conduct operations; or alternatively (3) using third-party commissionaires or distributors in the foreign jurisdictions.[16] These distribution outlets can be in the form of wholesalers that sell to retailers and/or company-owned retail operations. The comparability analysis and the compensation required for these operations will differ depending on the structure/function chosen for the business.

LRD is a term of art used for a buy-sell distributor within a MNE that, as described earlier, distributes products under its own name, for its own account, on behalf of the principal and has immaterial intangible property ownership. Under this arrangement, the distributor by contract is stripped of the majority of risks faced by companies acting independently in a market, such as significant inventory risk, warranty risk, foreign exchange risk, and research and development (R&D) risk. An LRD, while not owning any material intangible property, does possess an implied right to the intangible property solely for the purpose of selling its products. It does not engage in non-routine brand-building activities, nor should it incur the cost of promoting and developing a brand in its market. In a related-party context, a LRD typically would receive a relatively low level of compensation, necessary to perform its distribution functions, which can be derived under a

[16] While the decision on the structure should be dictated by commercial considerations, companies should recognize the tax implications involved in each of these options. Companies that operate through a branch in a foreign jurisdiction generally run the risk of being exposed to taxation on all of their income (as a permanent establishment), while utilizing third-party commissionaires will reduce tax exposure of the company within the foreign jurisdiction. However, managing large and extensive operations through a branch or third-party commissionaires is not practical. Therefore, setting up subsidiaries, either as limited risk or fully fledged risk, is the optimal route for expanding MNCs.

CPM analysis based on the profit earned by comparable independent distributors in a similar market performing similar functions.

By contrast, full risk distributors perform a greater number of functions, bear greater risks, and employ more assets, relative to LRDs. The full risk distributor's role is to sell and promote the parent entity's products to end customers in its market. The full risk distributor has more decision-making authority in areas such as pricing, contract terms, promotions, product mix, etc. The distribution functions may entail more product sourcing, quality control, shipping, after-sales services, and discount determination. Unlike LRDs, full risk distributors face risks similar to entrepreneurs', including market risks, inventory risk, financial risks and potentially higher AMP costs. Properly classifying the distributor's role and documenting it consistent with this role is critical because taxing authorities routinely challenge these classifications in their transfer pricing reviews.

The distributor may also engage in non-routine marketing functions, such as market research, strategic marketing and product advertising. A full risk distributor could therefore potentially create, use and own rights to any marketing intangibles that it generates. The degree of success in developing these intangibles may contribute to the success or failure of an entire MNC group. It would be expected that companies that own valuable non-routine intangibles and face a high degree of risk should also have the entrepreneurial profit opportunities/returns.

There are various sources of information that can be used to identify potential uncontrolled comparables. A common source of information is commercial databases that compile transactional and company financial data. In the United States, this information for publicly traded companies is based largely on filings with agencies such as the Securities and Exchange Commission (SEC). Outside the United States similar data is found through information filed with local stock exchanges and information voluntarily reported by the MNE. Some more common databases include Compustat, Global Vantage, Disclosure, Moody's, Worldscope and Amadeus. The databases can be used to conduct searches for appropriate comparables and analyze the relevant data using statistical analysis tools. Historical multi-year data on these comparables can be used to establish an arm's-length range of returns for benchmarking purposes. However, there are several issues that make transfer pricing analysis comparables difficult, including lack of comparable publicly traded companies and lack of reliable data.

Difficulty in identifying comparable transactions arises when transfer pricing benchmarking involves unique transactions that would not typically occur between unrelated parties. The main challenge that most transfer pricing practitioners face in benchmarking distribution entities is the lack of third-party comparable distributors. For instance, benchmarking a LRD would require identifying independent publicly traded companies that are: similarly sized as the LRD, within the same geographic region as the LRD, do not own any brands, operate under comparable low risk conditions, and with minimal decision-making powers.[17] These arrangements may be found between related parties, or among small privately held companies/individuals. However, in an open market, it is difficult, if not impossible, to limit or eliminate business risks such as fluctuations in prices and demand. In fact, given that most publicly traded companies operate on a larger scale, they typically assume higher levels of risk, perform complex functions, and may even

[17] In the United States and many other jurisdictions, the use of audited, publicly available financial data generally limits the analysis to public companies.

own certain marketing/operations intangibles. This is especially true in industries that have shifted towards vertical integration of various functions in a supply chain (e.g., manufacturing and distribution functions) and as a result eliminated independent companies providing intermediary functions. Consequently, absent comparability adjustments, it would be inappropriate to use the profits earned by such companies to benchmark LRDs.

Under the Regulations and the OECD Guidelines, the application of the CPM requires identifying and making reliable adjustments for the differences in assets, risks, and return profile between the comparables and the tested party. The most common adjustment is the working capital, or asset intensity, adjustments, including adjustments for the difference in inventory levels, accounts payable and account receivable. This is based on the rationale that because there is an opportunity cost of holding assets, companies in an open market should expect similar returns on similar levels of capital held. Therefore, making adjustments to balance sheets, in a way, places the tested party and the comparables on par with each other and calculates their profitability based on similar levels of asset.

Experience has shown that making other types of adjustments to comparables tends to reduce the reliability of the results derived under the CPM. The quantitative analysis required to adjust the analysis would be burdensome and highly complex. It would require a substantial level of economic research, modeling, financial analysis and additional fact gathering to estimate the potential adjustment.

When there seems to be no perfect set of comparables, practitioners are faced with the decision of either using imperfect comparables within the tested party's industry, or identifying an alternative set of comparables in an unrelated industry to benchmark the functions and risks of the controlled entities under review.

C. Marketing Intangibles Issue for Brands

In addition to the challenges in identifying reliable comparables, companies in the luxury and fashion Industry face challenges when dealing with subsidiaries that develop and utilize marketing intangibles. Generally, marketing intangibles can be defined, as previously noted, as an intangible derived from various valuable marketing and branding activities that develop the value of a trademark (i.e., give it brand value, image and market recognition), identifiable distribution channels and customer lists. In some respects, marketing intangibles create and maintain the core value of the brand, apart from its goodwill and quality control.

The concept of marketing intangibles initially gained prominence in the late 1980s, particularly in a docketed Tax Court case involving the sale of vacation destinations by a US distributor on behalf of a prominent foreign travel and vacation entity. The transfer price for the destination package was not directly at issue, but the level of AMP incurred by the US distribution entity for these sales was scrutinized. The IRS sought either to (i) disallow a portion of the AMP under the notion that it was incurred on behalf of the foreign trademark owner; or (ii) establish a service fee for the marketing efforts performed by the US distributor on behalf of the foreign trademark owner. While the case was settled by the parties prior to litigation, it foreshadowed the issues of today.

Subsequently, in 1994, the IRS issued final transfer pricing regulations under section 482, wherein it addressed the juxtaposition between the foreign owner of a trademark and the economic costs incurred by its US affiliate to promote and exploit that item of intangible property in its territory. In the examples provided in the regulations (referred to as the "Cheese Examples"), one can extrapolate a number of scenarios between the foreign parent trademark owner and its affiliated US distributor, such as where: (i) the US distributor was simply given a set transfer price and the development of the US market was at the risk and economic cost of the US distributor; (ii) the foreign parent indirectly subsidized the development of the US market through a reduced transfer price; and (iii) the foreign parent provided the distributor with a rebate of a portion of the distributor's AMP based on sales volumes. As applied, the Cheese Examples could require a return for the distributor's investment in the marketing intangibles either in the form of a service fee arrangement with an appropriate profit markup or more robust operating margins to reflect the return for the developed marketing intangible.

The *DHL* case, decided in 2002, became the next significant step in the evolution of the marketing intangible concept. The case involved the IRS's attempt to impute a trademark royalty for the use of the DHL trade name by DHL's foreign affiliates. The taxpayer disagreed, asserting that foreign affiliates bore the economic investment for the development of the DHL trademark, and thus should not pay a royalty. Finally, the appellate court held that under the section 482 Regulations, the foreign entities that made the economic investment for the development of the trademark in the foreign country were considered the owners of those intangibles for tax purposes and were entitled to the economic return associated with the marketing intangibles. The case established the "bright line" test, which notes that while every licensee or distributor is expected to incur a certain amount of cost to exploit the items of intangible property to which it is provided, it is when the investment crosses the "bright line" of routine expenditures into the realm of non-routine that economic ownership, likely in the form of marketing intangibles, is created.

However, numerous questions remain, such as how to define the company's marketing intangibles, how to determine the "bright line", i.e., where the level of AMP transcends from routine to non-routine expenditures, what really are brand-building expenses, what qualifies for these considerations (e.g., registration costs, legal costs), whether analysis of each underlying accounting code is required to segregate routine from non-routine expenditures, what allocation keys may be employed, and what the shelf life of the created marketing intangible is, as well as any preexisting marketing intangibles that are included within the considered intangible.[18] One practical issue is that the accounting for AMP may vary taxpayer by taxpayer.

The definition of non-routine expenditures is so industry and company specific that it may be impossible to apply in most cases. Similar companies within a similar industry may have vastly different approaches to their marketing philosophies, product launches, and/or product dependence or independence. These differences may even occur within the same companies and for similar product categories. These expenditures can also influence, among other things, the product's position in other countries, the timing of product launches, and the competitors and their products.

Further, there is no consensus on what expenses are truly brand building. Some would argue that pure advertising is not a brand-building cost. Instead, placements for specific events

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[18] See the following Indian cases, which have recently grappled with this issue: *Maruti-Suzuki Ltd v Commissioner of Income Tax Transfer Pricing Officer of New Delhi*, W.P. (C) 6876/2008) High Court of Delhi of New Delhi 2010, *LG Electronics (P) India v Assistant Commissioner of Income Tax,* ITAT New Delhi Bench January 23, 2013. See also Levey and Carmichael, "Market Intangibles Concept Forges in *LG Electronics India* Case", 14 *J. of International Tax*, February 2013.

(e.g., Super Bowl, the U.S. Open, the Americas Cup, etc.) produce lasting brand equity. As well, it can be said that celebrity endorsements create more brand building and brand association than pure advertising. Similarly, market campaigns and strategic focus groups geared to market knowledge, spending habits and market placement can be of equal value.

Considering these issues, it's clear that brand-building/development costs will be company specific and will require a detailed analysis to meet the ever increasing challenges of global tax authorities.

D. Comparability Analysis for Marketing Intangibles

Per the "bright line" test established by the *DHL* case, the key to determining whether a controlled distributor is the owner and the economic beneficiary of the developed marketing intangibles is to compare its AMP expenses to that of routine distributors in a market. This will require identifying comparable independent distributors to compare to the tested party. Thus, without reliable, independent economic benchmarks (i.e., comparables), it is more difficult to establish and defend intercompany profit allocations where marketing intangibles are present.

A key component of identifying appropriate comparables is to first review the expense categories and subcategories that comprise the company's AMP expenditures and determine whether independent benchmarks can be aligned with the company's AMP profile. While this exercise may provide a strong basis for establishing routine versus non-routine expenditures, the approach can be difficult to implement. The timing of expenditures, such as for product launches, may distort the relative importance of particular categories of AMP expense compared to others. Another challenge may be the need to separate routine and non-routine expenditures within a particular expense category, which presents the question of whether particular expenditure thresholds constitute a reliable definition of routine expenditures from non-routine ones. These factors obviously are fact specific and must always be evaluated in the context of the company's circumstances, its products and its industry. Nonetheless, even if this important initial step is reliably addressed, the identification of appropriate comparables remains a challenge.

The most significant difficulty in identifying comparables for marketing intangibles is that there are few (if any) data sources that provide sufficiently detailed information regarding the allocation of profits (i.e., value) attributable to the marketing intangibles. It might be possible to sidestep this issue by, for example, considering various rates of return on the cost of the marketing intangible of the investment, (such as a corporate hurdle rate of return). But this approach may not be entirely reflective of a market value for intangible property and the analyst is again faced with identifying an appropriate economic benchmark to reflect the investment and return characteristics of the marketing intangibles. One can also extrapolate from available information by reviewing the relationship of operating expenses to gross receipts to establish ratios to be applied to the taxpayer, but that analysis may be imprecise because operating expenses represent an aggregation of several expenditure classes. Public companies are not required to disclose their AMP expenditures in detail, and even for those that do, there is no way to determine the percentage of these expenses devoted to intangible property enhancement. Other financial statements, such as the balance sheet, do little to address this classification problem. When intangible assets appear on the balance sheet, they generally are the result of historical amortized costs or, if more recent, an asset allocation exercise that may assign accounting values across various asset classes (e.g., patents, trademarks and goodwill) that are not necessarily consistent with the required economic valuation of the subject marketing intangibles.

The search for clear industry standards that establish or provide guidelines for what a routine distributor should spend on AMP can be problematic. The financial statements of companies within an industry may classify and define AMP entirely differently. One company may define spending as advertising while another company defines similar spending as media or distribution. Other items, such as market studies, promotional brochures and media may be classified under completely different accounting codes.

Contributing to the difficulty is the uncertain definition of what exactly constitutes marketing intangibles. In addition to trademarks and trade names, marketing intangibles can be company or product specific and may also include customer lists and knowledge of distribution channels. Although customers are not considered to be "intangible" property per se, customers (and, more broadly, customer relationships) are a key value driver and one of the main indicators of growth potential. Similarly, transfer pricing practitioners often engage in discussions with the tax authorities over the value to be attributed to the "customer list" in the context of business reorganizations and supply chain restructuring processes. It is not precisely clear where in the financial statements expenditures related to the development of these items may be reflected. These factors, among many others, influence the actual return achieved from AMP expenditures and can vary widely from company to company.

Further, most contemporary databases that address trademark royalties (e.g., LiveEdgar, RoyaltySource and RoyaltyStat) contain information on license agreements between unrelated parties, but may not provide sufficient elements to segregate the remuneration paid for the intangible property (e.g., trademark) from the one paid, for instance, for ancillary services. Again, this is generally a factor of the amount of specificity contained in the underlying license agreement. Additional benchmarking and/or economic/financial modeling may provide alternative ways to produce meaningful results. Nonetheless, close comparability in terms of property, market and profit potential is rare, so that the result of the analysis may be a range of values for broadly similar property.

The level and nature of AMP also can be impacted by a variety of business factors, including management policies, market share, characteristics of the market, and the timing of product launches. As indicated above, the Annual Reports and SEC documents of public companies, as well as the information available from database providers, generally do not provide the necessary level of detail that would be required to reconcile these management considerations and classification differences.

An additional challenge to an analysis of marketing intangibles is that AMP generally has spillover effects to or from other products or product lines. Further, the effects of AMP are distributed over time, so that the accounting practice of expensing these AMP "investments" in the current period can create distortions in determining economic profits. This dynamic is most evident when dealing with issues such as a product launch, where there may be a sharp increase in spending prior to the launch of a product or product line, followed by subsequent decreases, to more stable spending levels. It might be appropriate to segregate the spending related to the product launch, or at least ensure that the data being considered covers a sufficient time period so that the lifecycle dynamics can be properly addressed. This requires estimations of the useful life of AMP. Economic modeling of investment cycles and profitability curves may address these types of issues, although the data required for such analyses may be significant and, in many cases, unavailable.

Given these challenges, tax authorities acknowledge the inherent difficulties of developing economic benchmarks for intercompany transactions – especially where the property and/or services is unique and not clearly documented in independent public market transactions. For this reason, both the Regulations and the OECD Guidelines encourage the taxpayer to develop information that provides the most reliable estimate of an arm's-length result. In other words, although there may be no "silver bullet" or irrefutable independent examples of arm's-length profit allocations where marketing intangibles are concerned, the presence of a legal agreement between the parties that clearly sets out rights and responsibilities, as well as a body of documentation that collectively supports the intercompany pricing, is the taxpayer's best opportunity to satisfy the requirements of the arm's-length standard. Accordingly, the best solution for attributing value to marketing intangibles may require a more creative approach to economic benchmarking, perhaps through a profit split or similar hybrid approach.

As an example, for a distributor that invests in AMP and brand-building expenses and an affiliate that developed and owns other market-based intangibles such as tradenames and trademarks, it may be possible to construct (or confirm) economic benchmarks based on the observed allocation of profits under similar arrangements. There are numerous examples of companies that license tradenames or trademarks to third parties and where the third party bears all AMP to market the licensed product. A review of the profits earned by the licensee compared to the license fee paid to the licensor will show how overall profits generally are split between the licensor and licensee. Assuming a sufficient number of comparable arrangements is available, the analyst may be able to use this arm's-length evidence to narrow the potential range of profit allocations among the parties by referencing comparable profit splits. Of course, adjustments may be necessary, such as separate profit allocations to manufacturing and distribution activities and alignment of functions between the benchmark arrangement and the tested parties. These adjustments may be minor or extensive, depending on the circumstances of the transaction and of the available comparables. They could include separate benchmarking of routine manufacturing and distribution activities using the Transaction Net Margin Method ("TNMM"), CPM, Resale Price Method and/or Cost Plus Method. Certain elements of intellectual property such as technology intangibles might also be addressed separately, perhaps through internal or external license agreements.

E. Flagship Store Tax Issues

In the luxury and fashion industry, the IRS and other taxing authorities have focused on flagship stores as brand builders, or another form of AMP. A flagship store refers to a retailer's leading store, often positioned in high-end retail locations, such as 5th Avenue and Madison Avenue in New York City, Rodeo Drive in Los Angeles, Avenue Montaigne in Paris, etc. The definition and type of flagship stores will vary from brand to brand. However, often the purpose of these stores is to create greater brand recognition and awareness among certain affluent group of consumers by carrying the company's newest high-end styles as well as a full portfolio of its collections. Flagship stores offer consumers a unique shopping experience by creating an atmosphere of "prestige" and "luxury" from the furnishings, product displays and background music, to the highly trained and sophisticated sales personnel.

Although flagship stores are typically larger in square footage than a retailer's other stores, they often carry either a selected collection of products or a full collection, with a focus on the most prestigious product lines that may be seen in corners of shop-n-shops of department stores. Given the cost and investment associated with the rental, design and the upkeep of flagship stores, these locations may have a lower profit per square footage than the company's standard retail stores, shop-n-shops and corners. However, it is expected that the flagship stores will increase sales in other locations locally and sometimes globally, and have other indirect effects on the brand image and value.

When these flagship stores are established and managed in a foreign jurisdiction by a company's distribution/retail subsidiary, tax authorities may disallow a portion of the cost in operating the store as brand-building expense allocable to the brand owner. The premise here is that these flagship stores are strategically positioned in locations where their presence and upkeep is of greater value than the revenue generated from the stores. The taxing authorities have often characterized the "excess rental costs" associated with flagship properties, due to their prestigious locations, as brand builders to be born by the brand owner, rather than the distributor. Of course, many flagship stores are profit making and this premise therefore fails. Hence, specific factual development is critical to avoid these stereotypical notions.

F. Period of NOLs

In conducting audits, tax authorities typically target distributors with reoccurring operating losses or significant net operating loss carryovers (NOLs). This is based on the assumption that these losses are exclusively due to non-arm's length intercompany pricing, and that captive distributors with limited risks should not incur losses over an extended period of time. However, a detailed functional analysis of the parties, review of any extraordinary events (i.e., the 2008 financial crisis) that may have occurred, examining the competitors' results, and determining the rational for AMP spending (i.e., market penetration) may reveal a different story for the losses.

NOLs refer to the tax period where a business reports operating expenses on its tax return that exceed its revenues. Due to fluctuations in income and expenses, a taxpayer can have substantial profits in one year and losses in another. With this in mind, the relief provisions of section 172 were enacted in the United States for business income and loss. This provision provides that NOLs may be carried back to two preceding years or carried forward to 20 future years as deductions against taxable income, thereby preserving the economic impact of the loss. The statute of limitations on audits relating to NOLs differs from the general three-year rule limitation. Section 6501(h) permits the IRS to assess a deficiency attributable to an NOL carryback deduction at any time before the expiration of the assessment limitation period for the tax year in which the net operating loss was created. Under the extended section 6501(h) limitation period, the IRS may assess a deficiency for additional tax for the year to which the taxpayer applies the carryback if the deficiency assessed is related to the carryback claim. In other words, even if the IRS cannot make an adjustment for a closed tax year, it can nevertheless disallow the use of NOLs generated in those years to any open tax year. As a result, companies with several years of operating losses could be subject to audit adjustments on all the years relating to those losses, and to the extent of the applicable losses in those years.

In conducting audits, tax authorities should be made aware of the numerous factors that can contribute to the operating losses of a retailer/distributor. A detailed review of financial statements may indicate that the losses may be due to potentially extraordinary items, such as closing of a store and/or opening of a new location, product withdrawals or launches, or other items that may or should be typically reflected below the operating profit line on a profit and loss statement because benchmarking is typically done at the operating level of the company, and these extraordinary items may distort the results.

Additionally, tax authorities should be made aware of the fact that start-up costs could lead to several years of losses as a company expands into a new market/region. Based on transfer pricing principles, a LRD would not be expected to bear these risk and costs, although some initial break-even years may be defensible. Thus, the determination of who should bear the expenses will be subject to the risk profile of the distributor. The question of how long a retailer in an open market should be expected to incur such losses largely depends on the level of the marketplace occupied by the taxpayer and the nuances of its market penetration strategy. Indeed, high-end luxury and fashion has a much longer market penetration period given the nature of its product and the more restricted nature of its consumers. Here, establishing brand loyalty requires greater cost and longer time periods of development, particularly when competing with well-established brands. Similarly, establishment of a sufficient sales base may require an extensive retail network across multiple channels. This can be time consuming and expensive, but necessary to gain the required critical mass to achieve the targeted level of profitability. Therefore, an appropriate decision on the treatment of losses and extraordinary expenses will rest upon a detailed functional analysis of the parties under review.

G. Intercompany Financing

Overview

As part of operating a global business, MNEs typically engage in internal financing transactions, such as lending, intercompany guarantees (including performance guarantees), cash optimization structures (cash pooling), and other treasury services (foreign exchange risk management, factoring and forfeiting, commodity risk management, captive insurance, asset management and carbon trading). Many of these transactions can be centralized within a single group entity, i.e., by establishing an intra-group treasury center. By means of establishing a treasury center, the group benefits from economies of scale reducing the amount of fees incurred when dealing with external banks. The main benefit, however, is that through centralization, the relevant risks can be monitored and managed more effectively. Although these treasury function transactions seem ancillary to the operations of a company, tax implications in structuring these dealings should be considered.

When analyzing these structures from a tax perspective, the following transfer pricing aspects should be taken into account: the arm’s-length debit and credit interest rates; the arm’s-length remuneration for treasury functions (i.e., cash pool leader that assumes credit risks), and the arm’s-length allocation of cash pool synergies. The increased likelihood of tax disputes resulting from intercompany financing arrangements reinforces the taxpayer's need to revisit their intercompany financing arrangements and implement policies and procedures that are in line with the change in the market circumstances.

Taxpayers should note that consistency, simplicity and transparency are essential from a tax as well as a commercial perspective. Business and economic rationales for loan and capital structure, standardized loan agreements, a limited number of maturities and currencies, and group borrowing in rating categories all contribute to maintaining consistency and robustness of pricing policy.

1. Intercompany Loans

Intercompany finance transactions are often considered in the context of tax optimization because of the treatment of interest (generally deductible, although with limitations) under the tax law of most countries. Therefore, there is a strong incentive to favor debt over equity when considering capital structure of a company. Hidden equity capitalization (or thin capitalization) is an issue that has become of extreme relevance in the context of the application of the arm's-length principle. Thus, many tax authorities have limited the use of intercompany debt – or, at least, the tax-deductibility of interest – by introducing a variety of thin capitalization rules, where deductibility of interest is limited by presumptive threshold of acceptable capital structures (such as debt to equity ratios or interest coverage ratios), which provide for an anti-abuse provision as well as, it is submitted, a "safe harbor" for taxpayers.

In the United States, the ability of a taxpayer to deduct interest on debt from a related party is contingent on whether the indebtedness is considered bona fide.[19] Section 385 of the IRC authorizes the IRS to determine whether an interest in a corporation for tax purposes is bona fide, and should be treated as debt (loan), or alternatively be reclassified as equity (stock). Distinguishing debt from equity is important in determining the proper tax consequences of corporate transactions. Reclassification of a debt instrument as equity will result in disallowance of interest deductions to the corporation, and taxation of dividends to the shareholders. Conversely, reclassification of an equity interest as a debt interest will result in disallowance of dividends-received deductions to any corporate shareholder, and the allowance of an interest deduction to the paying corporation. Section 482 adjustments may also be relevant in the event of such a reclassification by the IRS resulting in an increase in income.

Although there are no precise rules governing reclassification of a debt instrument as equity, section 385 and the case law interpreting the code section provide some guidelines and factors that should be considered when making such a determination. One major factor enumerated by the code to consider is the "Debt-Equity" ratio. If a company issues excessive liabilities relative to the capital contributions that it has received, the debt instrument could be regarded as an equity investment. This reclassification is based on the presumption that the risk in loaning to a thinly capitalized corporation is akin to the risk in making an equity investment. Although the code does not specify what debt-equity ratio would lead to such reclassification, courts have held that a corporation with a ratio greater than 1:3 could be deemed thinly capitalized. For US distributors of foreign MNEs, the earnings stripping rules of section 163(j) operate to limit currently deductibility

[19] (Regulation section 1.482-2(a)(1)).

of interest on the basis of certain debt to equity ratios. Non-deductible interest, however, can be called forward to applicable years.

Under the arm's-length standard, the, transfer pricing Regulations require payment of interest on intercompany loans and advances, at a rate that would have been charged between unrelated entities. Regulation section 1.482-2 allows taxpayers to use four approaches to document intercompany interest rates: (1) situs of the borrow rule; (2) applicable federal rate (AFR) safe haven; (3) general rule; and (4) trade receivable exception under Regulation section 1.482-2.

Situs of the borrower rule: The situs[20] of the borrower rule provides that "if the loan represents the proceeds of a loan obtained by the lender at the situs of the borrower, an arm's length rate is equal to the rate actually paid by the lender plus an amount that reflects the costs incurred by the lender in borrowing such amounts and making such loans".

Applicable federal rate (AFR) safe haven: Regulation section 1.482-2(a)(2)(iii) provides for a safe haven for bona fide debt, which may consist of term loans, advances or demands loans between members of a group of controlled entities, provided that the following conditions are met: (i) the loan or advances must be denominated in US dollars; (ii) the lender in an loan or advance transaction must not be in the trade or business of making loans or advances to unrelated parties at or about the time the loan or advance was made to a related party; and (iii) the situs of the borrower rules does not apply.

The AFR safe haven provision is based on the monthly published AFR. If the rate of interest charged is (i) not less than 100 percent and (ii) not greater than 130 percent of AFR, then the rate charged is consistent with the AFR safe haven provision and will constitute an arm's-length rate.[21]

For loans or advances with a term of less than three years, the short-term AFR effective on the date the loan or advance was made should be used. For term loans or advances over three years, but not over nine years, the mid-term AFR should be used. Finally, for term loans or advances over nine years, the long-term AFR should be used.[22] For all terms, AFRs are provided for annual, semi-annual, quarterly and monthly compounding periods.

Outside of the AFR safe haven and the situs of the borrower rule, there are no methods specified under the section 482 Regulations to evaluate an arm's-length interest rate. In practice, the principles of the transfer pricing methods established in the section 482 Regulations are relied upon to benchmark intercompany debt.

Trade receivable exception: Regulation section 1.482-2(a)(1)(iii) recognizes that interest is not required to be charged in an intercompany trade receivable for approximately three or four months if the debtor is located in or outside of the United states, respectively. This section also recognizes that longer interest-free periods can be applied when that is the regular trade practice in that industry.

[20] The IRS rulings and internal documents define "situs" as the "maximum geographic unit throughout which prevails uniformity in interest rate". The IRS has historically taken the view that a situs is a country.
[21] (Regulation section 1.482-2(a)(2)(iii)(B)).
[22] (Regulation section 1.482-2(a)(2)(iii)(c)).

2. Intercompany guarantees

Intercompany guarantees are usually extended to increase the borrowing capacity of related entities, assuming the guarantor's creditworthiness is better than that of the guaranteed entity. By issuing a loan guarantee, the credit provider (related or independent) no longer assumes the credit risk that is related to the debtor but, instead, the credit risk assumed relates to the creditworthiness of the guarantor, which is usually lower. Generally, the result of the guarantee is that the credit rating of the guarantor is passed down to the debtor, in exchange for a guarantee fee, thereby decreasing the risk assumed by the credit provider and ultimately resulting in more beneficial terms and conditions for the loan, including a lower interest rate or an extended borrowing capacity.

Under the transfer pricing standard, the price of guarantee fees between controlled or related taxpayers must be comparable to the fees between uncontrolled taxpayers under similar circumstances. Difficulty arises in this analysis because there is no consensus on classifying guarantees as the rendering of services, provision of debt or an insurance arrangement. Further, there is no universally accepted method for determining an appropriate guarantee fee. Consequently, a variety of methods are used to benchmark guarantee fees or estimate their value (as measure of benefit conferred), largely dependent on the circumstances of the transaction and the information on hand and when traditional methods are not practical. The following are a few methods typically used in such analysis:

Market approach: This approach tracks the CUP method intent in that it relies on fees associated with third-party transactions to benchmark guarantee fees. Data about third-party guarantees sufficiently comparable to intercompany guarantees are difficult to collect because they are not publicly available. In this case it may be possible to use third-party contracts such as credit default swaps (CDS)[23] and letters of credit as proxies.

Yield/spread (credit enhancement) approach: This method estimates the guarantee fee as the difference between the interest rate paid by the borrower with and without a guarantee agreement. In theory, an appropriate guarantee fee negotiated between uncontrolled issuers and guarantors would be: (1) no more than the benefit received by the issuer of the guarantee (otherwise the issuer would forego the arrangement); and (2) no less than the cost borne by the guarantor (otherwise the guarantor would forego the arrangement). These would be the lower and upper bound for an appropriate guarantee fee.

3. Cash Pooling

Intra-group cash pooling refers to a cash management technique that allows various entities owned by a common shareholder to combine their credit and debit positions in various accounts into one account, in order to allow for internal lending, facilitating hedging credit/foreign exchange risks, and reducing external (i.e., third party) financing costs to the group as a whole. The most common structure for cash pooling is the "zero-balance", where the individual member's account is "swept" to a target balance of zero on a daily basis.

[23] A CDS is a financial swap agreement that the seller of the CDS will compensate the buyer in the event of a loan default or other credit event. The buyer of the CDS makes a series of payments (the CDS "fee" or "spread") to the seller and, in exchange, receives a payoff if the loan defaults.

From the depositor's perspective, cash pooling participants should earn remuneration on their cash pool deposits consistent with what they would have earned if the cash deposits were made with a third party, i.e., the cash pool depositor should earn an interest rate consistent with that prevailing in money markets or with available banks for short-term demand deposits.

From a provider view, the cash pool leader should charge an interest rate for cash pool draws commensurate with the opportunity cost in making these loans. In other words, in an arm's-length setting, an unrelated party would not loan cash to another unrelated party at an interest rate below what it could earn by putting that amount to an alternative productive use, all else remaining equal.

Cash pool leader remuneration is dependent on the functions performed, risks assumed, and assets employed in intermediating borrowing and lending activities among cash pool participants. When a cash pool is structured as a zero-balancing cash pool (i.e., mixing of cash pool balances across legal entities), a banking/financial intermediary model can be an appropriate framework to determine cash pool compensation.

Alternatively, one can look to a service provider model to determine cash pool remuneration from an arm's-length perspective. The CPM can be used to determine the appropriate profit margin associated with engaging in the routine administrative services associated with accounting for debits/credits to the cash pool participants. This, however, will depend on the relative risks assumed by the cash pool leader.

4. Factoring

Another type of treasury function includes factoring, an asset-based financing in which a business sells its accounts receivable (i.e., invoices as assets) to another party (called a factor) at a discount to generate working capital and cash flow. In an intergroup setting, the factor is typically the entity that undertakes the treasury functions of the group. MNEs may utilize factoring to centralize certain functions and risks (e.g., in a shared services center). In an open market, factors typically change their customers a commission fee and an additional interest charge (if the factor advances charge).

For benchmarking purposes, several alternative methods might be used to assess the arm's-length nature of an intercompany factoring arrangement, by: (a) analyzing the profit achieved; (b) supporting the amount advanced to the assignor (the face value of the account receivable less the discount); or (c) evaluating the factoring discount itself. These methods include applying the CUP, CPM, or other unspecified methods based on the principles discussed above.

5. Hedging Risks

Generally, hedging activities undertaken by the treasury center involve entering into derivative contracts such as forwards, futures swaps, or options. These products allow the group to mitigate, for instance, foreign exchange risk, interest rate risk, market risk, etc.

The general provisions of Regulation section 1.482-2(a)(2)(i) provide guidance to price other financing and credit risk arrangements in an intercompany context. These general guidelines also direct taxpayers to the arm's-length standard in pricing for their treasury functions. The general considerations and methods described above should also be applied in these cases.

6. Value-added Taxes

The luxury and fashion Industry should generally face the ordinary value-added tax (VAT) issues that relate to services and supplies. In Europe, VAT is in general harmonized and regulated by the Council Directive 2006/112/EC of 28 November 2006 on the common system of value-added tax ("VAT Directive"). Even though the VAT Directive provides for a harmonized VAT system throughout Europe, it gives the Member States several options for the implementation of exemptions, tax rates, documentation and the like. Therefore, it is mandatory to not only rely on the VAT Directive, but to vet the VAT position with the applicable domestic law. The below explanations are based on the VAT Directive and should generally be valid for any Member State. In general, two different types of transactions can occur: (i) supply of goods; and (ii) provision of services. The guiding principle for both transaction types is that VAT should be tax neural for businesses and only be borne by the end consumer.

7. Supply of Goods

Where goods are supplied, a differentiation is needed for the domestic supply of goods, the importation of goods and the intracommunity supply of goods. The domestic supply of goods is the simplest situation and will trigger domestic VAT, which is deductible as input VAT for the purchaser.

The importation of goods usually triggers import VAT in the country the goods are customs cleared for free circulation within the European Union. The import VAT can be deducted as input VAT by the importer and should, therefore, not be a final cost. The deductibility of the import VAT as input VAT needs to be analyzed carefully, as, generally, only the business for which the goods are imported is allowed to deduct the input VAT. Usually, this is the seller, but in some circumstances this can also be the buyer. In the latter case, the seller cannot deduct the import VAT as input VAT even if he or she paid the same, but has to invoice the levy to the buyer, who can then deduct it. Depending on the circumstances, the supply subsequent to the importation may trigger domestic VAT in addition to the import VAT or it may be an intracommunity supply of goods as explained below.

An intracommunity supply of goods is given if a good is sold and as a consequence physically transported from one Member State to another Member State. For the seller, the supply is VAT exempt in the country where the good is dispatched as an intracommunity supply of goods. The purchaser has to record an intracommunity acquisition of goods in the country the goods are shipped to, declare the domestic VAT and deduct it as input VAT in the same tax declaration, resulting in a wash. Accordingly, the intracommunity supply of goods is VAT neutral, provided all conditions are fulfilled. Here, it is important to validate the VAT ID of the recipient, because only with a valid VAT ID can the intracommunity supply of goods apply. Further, it is paramount to keep documentary proof that the goods were shipped from one Member State to another. Without proof, the tax authorities may deny the application of the provisions on the intracommunity supply of goods.

8. Provision of Services

Cross-border services, such as licensing IP or know-how, the provision of work force or design services, are generally subject to the reverse charge system. This means that the service provider does not charge VAT on the amount invoiced but instead indicates on the invoice that the reverse charge system applies. The recipient has to calculate VAT according to his or her domestic VAT rate and can deduct the VAT as input VAT in the same VAT declaration. Thus, the procedure should result in a wash.

9. Year End Adjustments

It should not be overlooked that year end adjustments may trigger VAT obligations. In general, any adjustment of the price payable for a good or a service results in the adjustment of the assessment base for VAT purposes. This usually triggers the obligation to correct issued invoices and filed VAT declarations. However, in many countries the tax authorities waive the requirement to adjust the VAT and the corresponding documentation, if the payor is entitled to a full input VAT deduction. In the luxury and fashion industry, this should not pose a problem, like it would in the insurance or finance industry. However, not all countries follow this approach and, therefore, it is important to analyze the domestic laws of the countries concerned to avoid potentially being exposed to penalties.

10. Other Issues to Consider

VAT law is very formalistic and, therefore, it is important to comply with the documentation requirements to not result in the VAT being a final cost. The form and content of invoices as well as the validity of the VAT identification number of the recipient should be checked and validated periodically. Shipping and transport records have to be retained and VAT declarations filed in a timely way. In addition, it is advisable to periodically check and update the details (such as the address) of the beneficiary recipient of services or goods. Invoices showing a VAT liability and being addressed to a person that is not the beneficial recipient of the supply and/or service will result in the VAT being payable but at the same time not deductible for the recipient.

III. Tax Controversies

A. Summary of Above Issues

This section of the chapter seeks to identify some of the more prominent tax issues faced by companies in the luxury and fashion industry. As discussed earlier, transfer pricing is the single largest tax issue for all foreign-based MNEs and nearly the largest single tax issue for US-based MNEs. Accordingly, over the past decade, the focal point of audits conducted by tax authorities has been the allocation of income between related entities within an organization.

The intercompany allocation of profits should be based on the arm's-length standard, so that each entity is compensated based on the functions performed, risks assumed, and assets employed in conducting business. The US Regulations and the OECD guidelines permit taxpayers to contractually assign risk and functions among related entities and thus limit profits and/or development of IP to certain regions/entities.

For example, companies in the luxury and fashion industry can expand their operations abroad through related party retail/wholesale distribution subsidiaries. Depending on the business and/or tax objectives of the company, those subsidiaries can be structured as LRD or full risk distributors. The full risk distributor is expected to operate analogously to an entrepreneur and may assume financial and market risks, and incur expenses relating to AMP, and the operation of flagship stores to sell products and promote the brand. The distributor here should be (economically and legally) entitled to any marketing intangibles developed as a result of its efforts. On the other hand, LRDs are insulated from typical market risks in exchange for guaranteed, but lower, routine returns in operating the company's stores and distributing products to third parties. If the non-routine efforts of the LRD create marketing intangibles in a territory, the parent entity is expected to compensate the LRD on a cost plus basis. This arrangement will insure the parent entity will retain the economic and legal ownership of all developed IP globally in exchange for the cost and risk associated with its development.

Although those arrangements may not take place within two unrelated parties, taxpayers are obligated to price their transactions based on market standards and uncontrolled operations. Hence, the analysis involved in benchmarking intercompany transactions will be to a degree based on subjective determinations.

For instance, when conducting a search for comparable companies or transactions, practitioners are often faced with the issue of lack of perfect comparables. As was illustrated earlier, it is difficult to identify publicly traded companies that are comparable to a LRD. Consequently, taxpayers either perform adjustments based on certain variables, or supplement the benchmarking analysis with less comparable data. Such subjective determinations render companies' transfer pricing practices more prone to tax audits.

Further, the marketing intangibles issue has gained greater global attention during tax audits. Typically retail/wholesaler subsidiaries with recurring operating losses or significant NOLs are the subject of many audits. Tax authorities question, among other things, the extent of AMP and the role and value of the local country subsidiary's marketing efforts and flagship stores. At the height of the controversy is the juxtaposition between the legal owner of a trademark, and the economic costs incurred by the distributor to promote and exploit the trademark in its territory.

Lastly, transfer pricing principles should also be contemplated when companies engage in internal financing transactions with related entities. As part of operating a global business, MNEs typically engage in internal financing transactions, such as lending, intercompany guarantees (including performance guarantees), cash optimization structures (cash pooling), and other treasury services (foreign exchange risk management, factoring and forfeiting, commodity risk management, captive insurance, asset management, and carbon trading). Many of these transactions can be centralized within one single group entity, i.e., by establishing an intra-group treasury center. When analyzing these structures from a tax perspective, the following transfer pricing aspects should be considered: the arm's-length debit and credit interest rates; the arm's-length remuneration for treasury functions (i.e., cash pool leader that assumes credit risks); and the arm's-length allocation of cash pool advantage.

B. IRS Roadmap Procedures

Overview

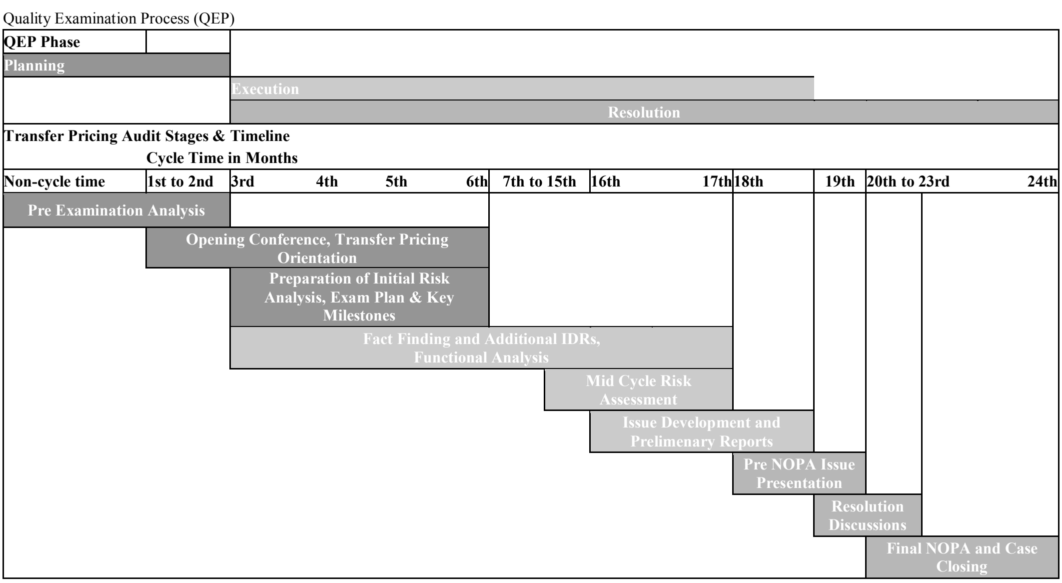
In February 2014, the IRS issued its Transfer Pricing Examination Roadmap. The stated goal of the Roadmap is to provide taxpayers and the IRS Examiners with audit techniques and tools to assist with the planning, execution and resolution of transfer pricing examinations. The Roadmap is organized along the lines of the IRS's Quality Examination Process. Three key elements emanate through the Roadmap. They are: (1) up-front planning; (2) factual development; and (3) determination of a reasonable commercial result.

While the Roadmap largely organizes and references existing case processing procedures, it is a work in process. The essence of the Roadmap has been used over the past year and has been, at times, productive in resolving cases. Yet, its initial use has not been without some difficulties, which is to be expected with new procedures. Its relevance to transfer pricing documentation is an obvious issue. The Roadmap makes clear that it seeks robust data during the course of an audit, and experience indicates that detailed functional and financial data are at the forefront. Accordingly, planning to include any relevant data in more detail in transfer pricing documentation can only operate to ease the fact-finding exercise of an audit.

Audit Procedure

Transfer pricing cases are usually won and lost on the facts. During an audit, the IRS conducts a thorough analysis of functions, assets and risks of the entities involved, and seeks to gain an accurate understanding of the company's value chain, competitive position in its industry, and financial results. Therefore, the Roadmap suggests a 24-month period, composed of three phases for conducting a detailed and systematic audit: Planning, Execution and Resolution. An overview of the Roadmap is depicted in the graph below:

TRANSFER PRICING AUDIT ROADMAP



The Roadmap is typically discussed during the opening audit. The Planning phase, which may take up to six months, entails pre-examination analysis, an opening conference, taxpayer orientation, and preparation of an initial risk analysis and examination plan. During the Planning phase of an audit, the key focus is on gaining a comprehensive understanding of the company's overall global business and profit drivers in the supply chain. In particular, the audit team looks for (1) the scope and location of any marketing and advertising activities; (2) description of patents, trademarks and other IP; (3) geographic and organization structure; and (4) segmented operational and profitability levels (by product lines, operational divisions and legal entities).

The documents reviewed during this stage include: annual reports and all publicly available information of the company, taxpayer's responses to the issued Information Document Request (IDRs), including request for transfer pricing documentation reports and legal agreements (as required by section 6662), and all tax documents relevant to controlled transactions, such as Treasury Forms 5471, 5472, 8833, 8858, and uncertain tax positions. The information gathered from these documents allows the auditor to compute key financial ratio analysis for multiple years, make industry comparisons, and make a preliminary consideration of whether cross-border income shifting is occurring.

In addition, a series of meetings is held with the taxpayer during this phase to, among other things, identify the key taxpayer operations personnel to interview during the audit, discuss the potential need for site visits, examine intercompany agreements and contracts, and review accounting data and records, including segmented financial statements, mapping from tax return to trial balance to general ledgers, list of cost centers and profit centers, and the taxpayer's accounting practice and policies. The audit team will also enquire about all intercompany transactions for the relevant years, such as the rationale for entering into the transactions, the taxpayer's value chain(s) associated with the intangible services and/or tangible goods, and whether the intercompany transaction is associated with the transfer of an income stream, or contribution of value of any intangibles. Each entity's contribution in the supply chain is especially scrutinized in cases where the overall company is profitable, while certain entities are at loss, or alternatively the overall entity is in a deficit while certain entities are quite profitable, particularly if those entities are located in tax-benefited jurisdictions. Attendees at these initial meetings typically include the taxpayer's tax, corporate and management departments, along with the audit team (International Examiners (IE)) and their manager, Economists and IT specialists, Engineers, Financial Products Field Counsel, District Counsel, Transfer Pricing Professionals (TPPs), the Domestic Team and their manager, and often an Industry Expert Analyst.

During the Execution phase, which may take up to 14 months, the audit team will continue to gather information to perform comparability and functional analyses of the relevant entities. They will review functions performed, assets employed and risks assumed by each controlled party. The due diligence in this phase may include issuance of additional IDRs, interviews with the taxpayer's employees (ranging from tax and management departments, to marketing and branding executions, merchandisers, store managers, HR, R&D teams, logistical employees, and other operational personnel and supply chain managers), and plant tours and site visits. Based on the information at hand, the audit team will conduct economic analysis to establish whether the taxpayer's transfer pricing method is reasonable and consistent with the arm's-length principle.

These findings are memorialized in a Report to accompany the draft Notice of Proposed Adjustments (NOPA) to the taxpayer.

At the Resolution stage, the audit team will meet with the taxpayer to present the government's findings on all issues and to determine whether an agreement can be reached prior to finalizing the NOPAs. The taxpayer and the audit team may also consider pre-appeals resolution opportunities. If, however, a resolution is not reached, the audit team prepares the Revenue Agent's Report, sometimes called the "RAR", or what is commonly called a 30-day letter and closing work papers.

On 12 August, 2014, the IRS posted a staff memorandum setting out "Rules of Engagement" for how its International Examiners and Transfer Pricing Specialists are to coordinate in handling transfer pricing issues.[24] This memorandum is intended as a companion piece to the Transfer Pricing Audit Roadmap. In essence, the memorandum describes the collaborative approach to be taken by both International Examiners and Transfer Pricing Specialist, which in most cases appears to retain primary decision making with the International Examiners. However, in extreme cases this decision-making process gets fuzzy, with the Transfer Pricing Specialist seemingly gaining more case-management control.

C. Alternative Dispute Resolution

1. Appeals

Overview

Once it becomes clear that the taxpayer and the Examination Team will not be able to reach agreement on all issues raised during an audit, the taxpayer should develop a strategy for moving the case forward on all unagreed issues. In particular, the taxpayer must decide whether to pursue negotiations with the Appeals Office, pursue Fast Track Settlement (discussed later), or proceed directly to court. From the taxpayer's perspective, typically the ultimate goal is a favorable settlement without a trial or court decision. The decision about how to proceed is an important strategic one in the proper development of the case. In reaching that decision, the taxpayer must undertake careful strategic planning with analysis of a broad range of significant factors, the importance of which vary from case to case. Nevertheless, if a reasonable settlement is impossible short of trial, then the taxpayer is well advised to proceed directly to court.

The IRS generally provides taxpayers with an opportunity to have their cases heard before Appeals. This opportunity, however, is not assured under the Code or the IRS's administrative guidance. Appeals generally has jurisdiction over both docketed and non-docketed cases involving: (i) income, profits, estate, gift, generation-skipping transfer, and miscellaneous excise tax; (ii) employment and certain excise tax liabilities; and (iii) additions to tax, additional amounts (i.e., penalties described in sections 6651 through 6665), and assessable penalties (i.e., penalties as described in sections 6671 through 6725).

[24] IRS IBC-TPP Rules of Engagement, www.IRS.Gov/Business/International-Business/IBC-TPP - Rules of Engagement.

2. Appeals Procedure

As an examination nears completion, the Examination Team will issue a NOPA for each issue being raised. For any issues not resolved during the audit process, the Examination team will issue a 30-day letter (Letter 950 – Straight Deficiency or Over-Assessment), accompanied by the RAR, and a computation of the tax deficiency (or overpayment) for each taxable year in question. To appeal the proposed adjustments directly to Appeals, the taxpayer must file a Protest Letter and Protest Brief (jointly, the "Protest") within 30 days of receiving the Letter 950. The Protest must include an itemized schedule of the proposed adjustments with which the taxpayer disagrees, along with a statement of facts supporting the taxpayer's position and a statement outlining the law or other authorities upon which the taxpayer is relying for any contested legal issue.

The Examination Team will also prepare a written report or "rebuttal" for Appeals, commenting on the Protest. The Examination Team's failure to adequately review and rebut the positions set forth by the taxpayer in its Protest Brief is a reason for Appeals to return jurisdiction of the case to the Examination Team under section 8.2.1.5 of the Internal Revenue Manual (Appeals Officer's Decision to Return Case).

Upon completion of the rebuttal, an opening conference is held, where the Appeals officers assigned to the case, the Examination Team and the taxpayer discuss (i) the need for further development of the case; (ii) the need for involvement of specialists; (iii) retention of expert witnesses; and (iv) the need for additional resources to assist in resolution of the case.

Appeals conferences are informal so as to promote frank discussion, mutual understanding and prompt settlement. Taxpayers may represent themselves before Appeals or appoint qualified representatives to act for them. While a taxpayer only is entitled to "reasonable, convenient conference opportunities", Appeals used to hold conferences with a taxpayer or its representatives provided there was reasonable progress toward a settlement. However, this practice may be changing as Appeals faces continuing pressure to resolve cases. A taxpayer should assume when determining its settlement strategy it may not have more than three meetings. Further, during the course of the Appeals process, where newly discovered evidence is submitted for the first time to Appeals in a case pending in nondocketed status, Appeals, in the reasonable exercise of its discretion, may transmit such evidence to the Examination Team for consideration or further development.

Appeals must handle cases objectively with the goal of reaching a sound decision based upon the merits of the issues in dispute, rather than with the pure intention of reaching settlements. Appeals Officers may agree to partial settlements covering less than all the issues raised by a case. Once a settlement has been reached, the Appeals Officer must prepare a report referred to as the Appeals Case Memo (ACM) describing the settlement and its basis for evaluation by a reviewing officer within the local Appeals Office. When a reviewing officer disapproves of a settlement favorable to the taxpayer, the Appeals Office must advise the taxpayer. Generally, the reviewing officer must give the taxpayer a conference to discuss the disapproval.

Appeals settlements generally are effectuated by executing a Form 870-AD, Offer of Waiver of Restrictions on Assessment and Collection of Deficiency of Tax and of Acceptance of Overassessment. The case may also be closed using a section 7121 formal closing agreement.

3. Fast Track Settlement

Fast Track Settlement (FTS) allows the IRS Examination Team and taxpayers an opportunity to mediate their disputes and resolve their cases expeditiously while the matter is still within the Examination Team's jurisdiction. The FTS program was designed by the IRS to expedite case resolution and to expand the range of dispute resolution options available to taxpayers. Taxpayers may find general guidance on the procedures in Rev. Proc. 2003-40, 2003-1 C.B. 1044. The IRS targets resolution of cases in FTS within 120 days of acceptance into the program.[25] FTS does not eliminate or replace other existing dispute resolution options, including Appeals. If a taxpayer does not achieve a satisfactory result through FTS, then that taxpayer may withdraw from the process and retain the ability to have the issue considered by Appeals.[26]

Controversies become eligible for FTS after the IRS issues the corresponding NOPA, and the taxpayer provides a written response, but *before* the Service issues a 30-day letter. In general, all issues for matters within the IRS's LB &I jurisdiction are eligible for FTS. Certain non-Large Business and International (LB&I) matters also may be accepted into the program.[27] Certain issues are *not* eligible for FTS, including:

a. Issues designated for litigation or those under consideration by the IRS for designation for litigation.
b. Issues for which a competent authority request has been filed;
c. Issues for which the taxpayer has requested simultaneous Appeals and Competent Authority consideration under Rev. Proc. 2006-54, 2006-2 C.B. 1035;
d. Issues outside of LB&I jurisdiction, unless approved by the Fast Track Program Manager and the compliance manager from the IRS;
e. "Whipsaw" issues, namely issues for which resolution of one party's issue will give rise to inconsistent treatment without another party's participation;
f. Issues that have been identified in a Chief Counsel Notice, or similar publication, as excluded from FTS. (To date, no such announcements have been issued); and
g. "Issues for which mediation would not be consistent with sound tax administration" (e.g., issues governed by closing agreements).[28]

The taxpayer and the Examination Team Manager must agree on participation in the FTS program; however, either may suggest participation. The FTS Managers, consisting of Appeals and the LB&I FTS personnel, ultimately determine whether the issues(s) under consideration are appropriate for FTS consideration.[29] If the FTS Managers deem the issue(s) appropriate for FTS consideration, then the taxpayer and the LB&I Team Manager apply to the FTS program by completing and executing a Fast Track Agreement Form.[30] The Fast Track Agreement Form must include the NOPA and the taxpayer's written response. The IRS Team Manager coordinates the application.[31]

[25] See Rev. Proc. 2003-40 § 2.01.
[26] See Rev. Proc. 2003-40 § 2.02.
[27] See Rev. Proc. 2003-40 §§ 3.01 and 3.02.
[28] See Rev. Proc. 2003-40 § 3.03.
[29] See Rev. Proc. 2003-40 §§ 3.02, 4.01, 4.02.
[30] See Rev. Proc. 2003-40 §§ 4.01.
[31] See Rev. Proc. 2003-40 §§ 4.01, 4.02.

The FTS Managers must approve the final Fast Track Agreement Form. If the application is not approved, the parties are notified within 10 days of filing their application.[32] The FTS Appeals Official will agree to a projected completion date for the procedure. The goal is to complete the process within 120 days.[33]

Under the FTS process, the Taxpayer and Examination Team negotiate the unagreed issue. The Appeals Official will not perform in a traditional Appeals role, but will use dispute resolution techniques to facilitate settlement between the parties. An Appeals Official staffs each FTS procedure. The Appeals Official is either (i) an Appeals Team Case Leader trained in mediation; or (ii) an Appeals Officer trained in mediation in conjunction with an Appeals Team Manager. An Appeals Official will meet with the taxpayer and the IRS representatives during the FTS procedure. At least one team member from each side must have decision-making authority.[34]

The parties will attempt to settle the issue designated for FTS through one or more meetings, as determined by the Appeals Official. The Appeals Officials will hold the FTS session at the date and location agreed to by both parties. The session may include joint sessions with all parties, separate meetings, or both, as determined appropriate in the sole judgment of the Appeals Official. Prior to the session, the Appeals Official will advise the participants of the procedures and ground rules. The Appeals Official may modify these rules and procedures to adapt to changed circumstances. It is important to provide all information in advance of the FTS procedure, as introduction of new information during the procedure may require the Appeals Official to lengthen the time for concluding the procedure.[35] Unlike Appeals, prohibitions against *ex parte* communications do not apply in FTS procedures.[36]

During the FTS procedure, the Appeals Official may propose a settlement. If, at the conclusion of the FTS procedure, the parties have resolved any of the disputed issues, the Appeals Official drafts a Fast Track Session Report outlining the terms of the settlement to be used to prepare calculations if the taxpayer accepts the proposal, but if the IRS Team Manager rejects the proposal, then the IRS Territory Manager must review the rejection and either concur with the rejection in writing or accept the settlement on the IRS's behalf. The signatures on the FTS Report do no indicate final settlement (i.e., do not constitute a closing agreement), but the basis for the settlement will not be altered once the FTS Report is signed. The Joint Committee on Taxation may also have to approve the proposed FTS.[37] The Appeals Officials can use Appeals settlement authority to resolve the issue and approve a FTS agreement. Alternatively, the taxpayer and the IRS team may resolve the issue using LB&I authority, and that issue will be reflected in the RAR. If no agreement can be reached, then the case is closed and treated as unagreed. The taxpayer retains the option of pursuing settlement through the traditional Appeals process.

As a practical matter, the FTS procedure has worked efficiently, produced reasonable results, and saved considerable outside service provider costs when compared with litigation.

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32 See Rev. Proc. 2003-40 § 4.02.
33 See Rev. Proc. 2003-40 § 4.03.
34 See Rev. Proc. 2003-40 §§ 5.01, 5.02.
35 See Rev. Proc. 2003-40 §§ 5.03 and 5.05
36 See Rev. Proc. 2003-40 § 5.11; see also Appeals *ex parte* rules discussed *supra* Section Five, Part II.M.
37 See Rev. Proc. 2003-40 §§ 5.07 and 5.08.

D. Mutual Agreement Procedures

A taxpayer may request competent authority assistance in the following circumstances:

1. Early Referral

Overview

The Appeals Early Referral Procedure (ERP) is a process by which the taxpayer and the Examination Team can accelerate audit issues to Appeals for resolution on an issue-by-issue basis during the audit. The purpose of ERP is to expedite resolution certain issues ("eligible issues") at Appeals while the remaining issues in the case are being developed by the Examination Team. ERP resolves cases more expeditiously by enabling the Examination Team and Appeals to work simultaneously. This process is optional and may be requested by any taxpayer.

The Examination Team is not involved in the early referral negotiations. The Appeals ex parte communications rules apply to communications between the Examination Team and the Appeals Officer in an early referral procedure.

Generally, the IRS will consider permitting ERP for any issue that, if resolved, can reasonably be expected to result in a quicker resolution of the entire case; that both the taxpayer and the Examination Team agree should be referred to Appeals early; is fully developed; and is part of a case where the remaining issues are not expected to be completed before Appeals could resolve the early referral issue.

On the other hand, the IRS will not permit ERP for issues that fall into any of the following categories: not fully developed; the remaining issues in the case are expected to be completed before Appeals could resolve the early referral issue; is designated for litigation; the taxpayer has filed/intends to file a request for U.S. competent authority assistance; or is part of a whipsaw transaction.

2. Procedure for Requesting Early Referral

The taxpayer must submit a written request for ERP and identify the taxpayer and tax periods, state each issue for which ERP is requested, and describe the taxpayer's position with regard to the issues, including a brief discussion of the material facts, and an analysis of the facts and law as they apply to each issue.

The early referral request, and any supplemental submission (including additional documents), must include a signed perjury statement declaring that the facts presented are true, correct and complete. The declaration must be signed by a person authorized to sign the taxpayer's federal income tax return.

The IRS case/group manager will attempt to notify the taxpayer of the decision to accept or reject an issue within 14 days of receiving the request. There is no formal taxpayer appeal if the early referral request is denied in whole or in part. However, the taxpayer can request a conference with the supervisor of the case/group manager who denied the early referral request.

If an issue is approved for early referral, the Examination Team will complete a Form 5701, the NOPA for that issue, and send it to the taxpayer. The taxpayer must respond in writing to each

NOPA within 30 days from the date the NOPA is sent. If the response is not received in a timely fashion, the early referral request will be considered withdrawn regarding that particular issue, without prejudice to the taxpayer's right to an administrative appeal at a later date.

Generally, established Appeals procedures, including those governing submissions and taxpayer conferences, apply to early referral issues. If an agreement is reached in this process, a closing agreement is prepared. However, if negotiations are unsuccessful, the taxpayer has two alternatives: (i) request mediation for the issue; or (ii) litigate. Further Appeals consideration following an unsuccessful negotiation is foreclosed unless there is a substantial change in the circumstances regarding the issue. If a taxpayer withdraws an early referral request for an issue, the withdrawal will be treated as if no agreement was reached and Appeals will not consider the issue further.

If the Examination Team concludes its examination of any taxpayer issues not referred as part of the early referral process, it will issue a 30-day letter with respect to unagreed issues. The letter will include any issues referred under the early referral process that still are pending in Appeals at the time the examination concludes. The taxpayer may protest any unagreed issues not submitted to the early referral program at the end of the examination. Appeals will continue to consider any early referral issues still pending, in addition to the new unagreed issues. If the only unagreed issues present in the case at the time the examination concludes are issues that Appeals considered on early referral and returned to the Examination Team unagreed, the Examination Team will issue a statutory notice of deficiency.

3. Advance Pricing and Mutual Agreements

The IRS's Advance Pricing Agreement (APA) Program was developed in 1991 as an alternative to the traditional examination process, and was intended to provide a forum for taxpayers to resolve actual or potential transfer pricing disputes in a principled and cooperative manner. An APA is akin to an advance ruling, where taxpayers submit a request to the IRS for a ruling on the company's proposed arm's-length pricing for certain covered intercompany transactions ("covered transactions").

In 2012, the APA Program was combined with the Office of the U.S. Competent Authority to form the Advance Pricing and Mutual Agreement (APMA) Program within LB&I. The "realignment" of the APA Program and the U.S. Competent Authority functions was intended to, among other things, increase resources and efficiency in handling transfer pricing matters, including APA Requests. The APMA Program offers taxpayers an opportunity to negotiate and enter into a binding contract with the IRS pursuant to which the IRS agrees not to seek a transfer pricing adjustment for covered transactions if the taxpayer files its tax return for a covered year consistent with the agreed transfer pricing method (TPM) and price.

Also, the successful negotiation and execution of an APA eliminates, as a practical matter, any exposure to penalties under section 6662(e) that might otherwise exist. Thus, the often substantial costs of consummating an APA are mitigated somewhat by relief from preparing annual section 6662(e) documentation for the covered transactions and costs associated with contentious transfer pricing audits and controversies, and time-consuming financial statement audit issues.

Taxpayers may request a bilateral, multilateral, or, if appropriate, unilateral APA. A bilateral or multilateral APA involves a request for an APA between the taxpayer and the IRS, accompanied by a request for a mutual agreement between the U.S. competent authority and tax authority of a treaty partner county. A unilateral APA involves only an agreement between the taxpayer and the IRS. If the covered transaction involves a related party located in a country with which the U.S. has an income tax treaty, the stated preference of the APMA Program is to consummate a bilateral APA to limit the taxpayer's exposure to double taxation. If the APA Request is unilateral and involves transactions with an entity in a treaty jurisdiction, the taxpayer must explain why it is not requesting a bilateral APA. However, the APMA Program will accept a unilateral APA Request, even in circumstances where the other related party is located in a jurisdiction with a tax treaty containing a mutual assistance procedure, where the circumstances warrant a unilateral request.

Over the past several years, the number of U.S. treaty partner countries with APA regimes has increased, allowing more taxpayers to utilize the APA system to gain certainty in their tax policies. Also, globally, there seems to be a reduction in processing time (between submission and approval) to complete an APA, making this an increasingly attractive option for taxpayers.

The APA process generally begins with one or more Prefiling Conferences. The Prefiling Conference may be held either on an anonymous basis, or with full disclosure of the taxpayer's identity. Prefiling Conferences are intended to clarify: (a) Whether the taxpayer's facts and circumstances are suitable for an APA; (b) The nature of data, documentation and economic analyses that will be required to evaluate the APA Request in a timely and efficient manner; (c) The appropriate user fee; (d) The scope of the Covered Transactions and the suitability of potentially applicable TPMs to test the arm's-length nature of such transactions; (e) The appropriateness of, and procedure for, reaching a competent authority agreement regarding the proposed Covered Transactions (assuming a bilateral APA Request is contemplated), or the receptivity of the APMA Program to unilateral consideration, if a unilateral APA Request is proposed in conjunction with Covered Transactions involving a related party in a treaty jurisdiction; and (f) The IRS's proposed schedule for evaluation of the APA Request (which is known as the "Case Plan" when finalized after an APA Request is filed).

Following the opening conference, the taxpayer will determine whether it is willing to proceed with the APA request. If so, the taxpayer must prepare a detailed APA request, based on the guidelines set out in Rev. Proc. 2006-9.[38] Generally an APA request must provide the following items: background information on the company, including organizational charts and financial data, discussion of transactions under review, detailed functional analyses of the entities involved, steps performed in undertaking economic analyses to support the proposed TPM, and the intercompany pricing.

The APMA team will review the APA request and schedule an opening conference shortly thereafter. During the meeting, the taxpayer is introduced to the APMA team assigned to the case and the submission is discussed in more detail. The due diligence process may involve site visits by the APMA team and/or other tax authorities, issuance of follow-up questions, and scheduling of follow-up meetings.

[38] Rev. Proc. 2006-9 is currently under review by the IRS and an updated Rev. Proc. will be issued by the end of 2014.

Once the APMA team has developed a position on the taxpayer's submission, in the case for bilateral and multilateral APAs, the U.S. team will begin negotiating their position with competent authorities of treaty partner countries. Soon after an agreement has been reached with the opposing country, the IRS will draft an agreement (the APA) to be signed by both the taxpayer and the IRS. The APA agreement typically covers a five-year period and requires that the taxpayer provide annual reports to the IRS to demonstrate compliance with the terms of the agreement.

4. Competent Authority

A bilateral tax treaty generally permits a resident of the U.S. or a resident of the treaty partner to request competent authority assistance when the actions of the U.S., the treaty partner, or both, may result in taxation that is contrary to the provisions of the treaty. Such actions, if not addressed, will often result in two tax authorities imposing tax on the same stream of income (e.g., double taxation). Under the U.S. income tax system, double taxation can be eliminated in essentially one of two ways: (i) relief pursuant to a bilateral treaty; and (ii) unilateral relief through the U.S. foreign tax credit system.

U.S. income tax treaties generally contain a mutual agreement procedure (MAP) article that authorizes designated representatives of two treaty partners (the "competent authorities") to resolve any cases arising from differing applications of the treaty provisions by the treaty partners and to otherwise resolve issues of double taxation arising under the applicable treaty. The MAP article serves as the primary mechanism for resolving such disputes. Although competent authorities are only required to make a good faith effort to reach an agreement eliminating double taxation, historically the vast majority of competent authority cases have been resolved with the taxpayer obtaining complete or partial relief from double taxation.

As of February 2012, competent authority requests related to transfer pricing, and permanent establishment issues, including profit attribution issues, have been handled by the newly restructured APMA Office (see the 'Advance Pricing and Mutual Agreements' section for more information). Cases that do not involve one of these identified issues are handled by the Treaty Assistance and Interpretation Team, which is housed in the office of the Assistant Deputy Commissioner (International), LB&I.

The overwhelming majority of the cases addressed by the U.S. Competent Authority involve double taxation arising from an allocation under transfer pricing regulations. However, Competent Authorities will consider cases involving requests: (a) to defer the recognition of profit, gain or income with respect to property alienated; (b) to determine the tax residence; or (c) to determine whether the taxpayer is entitled to the benefits of a treaty under specific limitation on benefits provisions.

A taxpayer may request competent authority assistance at any time after the IRS communicates the amount of a proposed adjustment in writing to the taxpayer. However, prior to filing an initial request for assistance, taxpayers may schedule a Pre-filing Conference with the competent authority. Issues covered during the conference normally would include (i) the timing of the request; (ii) the taxpayer's views regarding the merits and possible compromise positions that it might accept; (iii) the competent authority staff's experience with past positions taken by foreign tax authorities; (iv) the type of factual and economic analysis that should be included in the competent authority request; and (v) various practical issues that inevitably arise.

A request for competent authority assistance must be in the form of a letter addressed to the Deputy Commissioner (International), LB&I Division, and the submission prepared based on guidelines set out in Rev. Proc. 2006-54.[39] Generally, the request must provide, among other items, the following: (i) a reference to the specific treaty and provisions under which the request is made; (ii) identifying information for the taxpayer and related persons in the matter; (iii) a brief description of the issues for which competent authority assistance is requested; (iv) the years and amounts relevant to the request; (v) an explanation of the relief sought for the issues raised; and (vi) a statement as to whether the period of limitations has expired for the years for which relief is sought either in the United States or in the treaty country. In addition, taxpayers should provide all transfer pricing documentation reports relating to the years at issue that support their position as filed.

Upon accepting a request, the AMPA team assigned to the case will begin the due diligence process and may also conduct their own analyses. The due diligence process may involve site visits by the APMA team and/or other tax authorities, issuance of follow-up questions, and scheduling of follow-up meetings.

Once the APMA team and the foreign competent authority have developed their respective positions on the taxpayer's case, the governments will begin negotiating their positions. Although competent authority negotiations are a government-to-government activity that does not include the taxpayer's participation, the U.S. Competent Authority will maintain a dialogue with the taxpayer during the negotiation period to help ensure that any settlement will be acceptable to the taxpayer.

If the competent authorities fail to agree or if the agreement reached is not acceptable to the taxpayer, then the taxpayer is free to withdraw its request and pursue any other available administrative or judicial remedies in either or both jurisdictions.

If the taxpayer accepts the resolution reached by the competent authorities, the agreement shall provide that it is final and not subject to further administrative or judicial review. The taxpayer will be requested to reflect the terms of the mutual agreement and of the competent authority assistance provided in a closing agreement.

5. Simultaneous Appeals/Competent Authority

Rev. Proc. 2006-54 provides an option for competent authority relief – the Simultaneous Appeals Procedure (SAP) – for IRS-initiated adjustments. The SAP is initiated by the taxpayer electing the procedure either as part of the initial request for competent authority assistance or in a separate submission to the competent authority. The U.S. competent authority also may request IRS Appeals' involvement if it determines that such involvement would benefit IRS interests. The taxpayer may withdraw its request for the SAP at any time.

When the SAP has been invoked, the case will be handled jointly by the competent authority and the relevant Appeals Officer, who will attempt to reach a "tentative resolution" of the issue prior to presentation to the foreign competent authority. Their tentative resolution of the case will serve as the basis for the U.S. competent authority's position in the subsequent competent authority proceeding.

[39] Rev. Proc. 2006-54 is currently under review by the IRS and an updated Rev. Proc. will be issued by the end of 2014.

The SAP, at least theoretically, may be attractive to taxpayers in cases where the field was overly aggressive or did not properly develop the case. In these cases, involvement by Appeals can be beneficial, because the competent authority analyst may push Appeals to withdraw or compromise the proposed adjustment, so that it can adopt that position in the bilateral negotiations. In the majority of cases, however, it does not appear that the SAP has been particularly beneficial to the taxpayer. In recent practice, the U.S. competent authority has, in at least some cases, commenced bilateral negotiations based on the proposed IRS allocations without waiting for an SAP Appeals resolution.

IV. International/Regional Concerns

A. European Region

United Kingdom

The UK is a major market for many of the biggest names in the luxury and fashion industry, with many groups operating flagship stores in London as well as trading in several of the UK's other large retail centres. In recent years the UK tax authority, HM Revenue and Customs ("HMRC") has increased its scrutiny of pricing in the industry: e.g., cross-checking prices where there is dual or multiple sourcing. Tax authorities tend to look closely into arrangements where goods are sold at higher prices in some group stores than in others. As far as marketing intangibles are concerned, the chief issue will be whether to centralize ownership or not. The pricing models most commonly seen are (1) licensing of the brand to the UK retail operator, who pays a royalty and sources the products from affiliates; (2) principal type-structure, with the brand owner selling the product to local affiliates in return for a price reflecting the embedded value of the IP; and (3) the stand-alone model, with the local company taking on its own expenditure in terms of marketing or advertising brands.

1. Transfer Pricing and Other Issues

Overview of Rules. The UK's transfer pricing legislation follows the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The rules require UK resident companies to calculate their taxable profits from transactions entered into with associated companies (whether UK-resident or otherwise), on the basis of the arm's-length principle. UK resident companies are also required to prepare and retain documentation to demonstrate that the arm's-length principle has been appropriately applied. Under corporation tax self-assessment, the obligation to prepare an arm's-length tax return falls upon the company, and tax-related penalties may be imposed if the company carelessly or deliberately fails correctly to apply the transfer pricing legislation.

Difficulty of Establishing Comparables. It is generally not too difficult to find comparables when using a centralized IP structure. The task is more problematic when the benchmarking involves the stand-alone model. This difficulty will often relate to the level of financial and other types of risk assumed by the tested party. For example, should a higher degree of risk produce a higher return (and therefore reduce the amount of royalty)? A royalty for a premium brand will be high, and it may well be hard to benchmark. Often, the UK entity is a wholly owned operation. In other countries, the equivalent entity is a joint venture of franchise. One question that arises as a result is whether a third-party-type arrangement can be used as a comparable for a wholly owned entity?

Marketing Intangibles Issue for Brands. As mentioned above, different issues will arise depending on the structure that is used. One particular tax issue that a UK company will need to consider is whether it is able to amortize expenditure on the brand. This will be possible if the brand was created or acquired after 31 March 2002 and therefore qualifies as "new IP" for UK tax purposes. A different tax regime applies to "old IP" created or acquired before 1 April 2002. Expenditure on new IP qualifies for an annual amortization debit for tax purposes in line with the amortization debit in the company's accounts.

Flagship Store Tax Issues. HMRC commonly raises questions concerning compensation for the flagship store. For example, should the entity operating these flagship stores be earning a higher profit, or should it be compensated to a higher degree for its activities (if it makes losses)? In many cases, as the prime function of the flagship store will be to generate brand value rather than profit, the argument for greater compensation could be challenged on this basis. There can be a number of risk allocation issues surrounding the flagship store, including which entity in the group bears the risk of extraordinary expenditure, e.g., fire or flooding. Should this be covered by local insurance, which may be inadequate, or should there be global reimbursement? What happens if the flagship store closes? To which account should the associated costs (e.g., repairs required on terminating the lease) be booked? Where should compensation be paid?

A specific UK tax issue arises in relation to fit-out costs of a flagship store, which can result in a higher effective tax rate for a UK entity within the group. Fit-out costs are capital expenditure that will not qualify for capital allowances (which are only available for what is spent on plant and machinery), so the costs are not deductible for tax purposes. The group's transfer pricing policy would normally determine a local entity's return as a margin on sales, typically 3–5%, by reference to the profit and loss account. These non-deductible costs will be reflected in the profit and loss account, but disallowed in computing taxable profit, so the entity's return for tax purposes is increased. A similar issue arises in relation to store closure costs, a portion of which would typically be capital expenditure and not deductible.

Period of NOLs. There will almost always be significant opening costs and running expenses associated with a flagship store, leading to losses initially. In the UK, operating losses over a period of three to five years would normally be acceptable to the tax authorities.

Financing/Reclassification. There is no specific financing rule for the luxury/fashion industry, but there are certain anti-avoidance rules the group should take into account. These are: (1) Thin capitalization, which restricts deductible interest expense for a UK resident company on a loan from an associated company by comparing what it could have borrowed from an unrelated party on the strength of its own balance sheet. The rule also applies to a loan from an unrelated lender with a guarantee or other credit support from a related party. (2) Anti-arbitrage rules, which apply to deny a deduction, or create a taxable receipt, where a company subject to UK tax is party to a scheme involving hybrid entities or hybrid instruments, and the main purpose, or one of the main purposes, is to achieve a UK tax advantage. (3) The worldwide debt cap, which limits the deductible interest expense of UK members of a group by reference to the aggregate external interest expense of the worldwide group of which the UK company is a member.

Value-added Tax. The activities carried out by UK entities in the group will be taxable supplies for VAT purposes, meaning that any VAT incurred (e.g., on advisory fees, lease rental payments) should be fully recoverable. Companies under common control that each have an establishment in the UK may be able to form a VAT group, and supplies between VAT group members are ignored for VAT purposes. There are strict compliance obligations under the UK VAT regime; in particular, for the regular submission of VAT returns.

2. Tax Controversies

The main points to be aware of from a UK perspective are therefore the levels of compensation and risk associated with the flagship store, including the knock-on effect of non-deductibility of fit-out costs, reading across different types of ownership structures when using comparables and the restrictions on interest deductibility.

Transfer pricing enquiry

HMRC's guidance sets out the transfer pricing documentation that should be kept by a UK company (which is neither small nor medium-sized, in which case the transfer pricing rules do not apply). The principal requirements are: primary accounting records, tax adjustment records, records of transactions with associated businesses to which the transfer pricing rules apply and evidence to demonstrate an arm's-length result.

HMRC makes a decision based on risk as to whether to open a transfer pricing enquiry. Once an enquiry is launched, HMRC uses enquiry action plans and timetables, which act as "roadmaps" for the enquiry. HMRC will establish an enquiry timetable with the taxpayer at an early point, providing for key stages of the enquiry, including details of each phase, dates for regular progress meetings or calls with the business, issue of information requests, time limits for the business to respond and for key meetings. HMRC would expect to have access to the relevant personnel in the business for the purposes of meetings and interviews. In most cases, the enquiry would be expected to last no longer than 18 months. However, a longer timescale (but of no more than 36 months) may apply in exceptional cases that are both particularly complex and high risk.

3. Alternative Dispute Resolution

Facilitated mediation is an available option and HMRC is keen on considering this as an alternative to litigation in suitable cases. The use of APAs, ATCAs and the MAP is high and the number of unilateral APAs is on the increase. However, it is becoming more difficult to reach agreement on cases through these means.

4. International/Regional Concerns

A major current concern is the valuation of brands. There appear to be totally different perspectives from country to country, even within Europe, with some, such as China, claiming that brand value is significantly lower than many other countries would consider to be the case.

Current areas of focus for HMRC are: (1) identification of intangible assets and determination of whether an intangible asset has been transferred, e.g., in business restructuring; (2) substance of operations in a particular country and, in particular, the location of significant people functions; and (3) whether a service activity is sufficiently routine to be characterized as a cost plus service or whether greater returns calculated on a different basis such as profit split should be associated with the activity.

Germany and Austria

Germany is also a major market for many of the biggest names in the luxury and fashion industry, with many groups operating flagship stores in Berlin, Frankfurt, Munich and Düsseldorf, as well as trading in several of Germany's other large retail centers. Austria is a comparably small market, but flagship stores of those luxury and fashion brands can be found in Vienna. Vienna is a particularly interesting market for these brands because of the buying power of Asian and Russian tourists.

Because of strict domestic laws and supplemental legislative regulations, German tax authorities critically examine supply chain restructuring, stripping and transfer of functions, and the resulting necessary compensation payments. The same tendency can be seen in Austria, with the difference that Austrian law does not provide for specific regulations, as does German law. Thus, the legal basis for requesting compensation payments is less clear.

For intangibles, and especially because of the developments prompted by BEPS and the European Union, more emphasis will be placed on the beneficial ownership of IP rights and the attending substance. Both German and Austrian law have always had anti-abuse rules in their domestic legislation that would allow transactions not to be recognized if one party to the transaction lacks sufficient substance. However, supported by global policy developments, it can be expected that even more focus will be placed on this issue in the future.

1. Transfer Pricing and Other Issues

Overview of Rules. Germany's transfer pricing legislation in general follows the OECD Guidelines; however, German law provides for specific domestic transfer pricing and documentation rules. The German transfer pricing rules are scattered over various codes, with the most important one in Section 1 of the Foreign Tax Act (*Außensteuergesetz*, (AstG)) and rules on hidden dividend distributions in section 8 para 3 of the Corporate Income Tax Act (*Körperschaftsteuergesetz* ((dKStG)). Section 1 of AStG is supplemented by legislative regulations, of which the most important is the *Funktionsverlagerungsverordnung* (FverlV), detailing the consequences of the transfer of functions. Other important rules can be found in the German Fiscal Code (*Abgabenordnung* (AO)), which provides for the general documentation obligation (section 90 para 3 AO) as well as the right of the tax authorities, to estimate the income of the taxpayer (section 162 AO). The federal statutes are supplemented by a series of administrative regulations, which are only binding on the tax authorities.

The Austrian legislation is less complex and follows the OECD Guidelines, which are supplemented by domestic Guidelines on Transfer Pricing Matters 2010 (the Austrian Guidelines). Neither the OECD Guidelines nor the Austrian Guidelines are legally binding, but are used as a means of interpretation. Similarly to the situation in Germany, the Austrian Guidelines are only binding on the tax authorities. Under Austrian domestic law (in particular, section 6 N°. 6 of the Austrian Income Tax Act [*Einkommensteuergesetz* (EstG)) and section 8 of the Austrian Corporate Income Tax Act (*Körperschaftsteuergesetz* (aKStG)), transactions between related parties must follow the arm's-length principle.

Difficulty of establishing comparables. When looking for comparables for transactions involving IP, generally any and all aspects that can influence the royalty rate to be charged have to be considered, including the profit potential of the licensee. Data bases will usually not provide any data on the profit potential of the licensee and, thus, in practice the comparability will predominantly be based on the nature of the intangible and the industry. A royalty for a premium brand will typically be high, and it may well be hard to find third-party data that is fully comparable. Where no fully comparable data can be found, German law stipulates that the third-party data must be adjusted and only the interquartile range can be used, versus the full range when fully comparable data can be found. It is another question whether internal transactions with unrelated parties can be used where available. In a case involving a distribution company, the German Fiscal High Court (*Bundesfinanzhof* (BFH)) ruled that internal comparables cannot be considered fully comparable if, inter alia, transactions with unrelated parties only accounted for 5 percent of the total revenue of the distribution company. This reasoning is likely not applicable to the benchmarking of license fees, but the comparability of internal comparables has to be scrutinized carefully.

The Austrian Guidelines do not go into much detail when assessing an arm's-length royalty rate. It is stated that the royalty rate has to be assessed based on revenue and not profit, and that both the licensor's and licensee's position have to be considered. Also, internal comparables should be considered where appropriate. In general, Austrian law limits the deductibility of royalties if they are paid to a related company that is subject to no or low taxation. "Low taxation" here is a nominal or effective tax rate of less than 10 percent.

Marketing Intangibles Issue for Brands. In Germany and Austria, intangibles can only be entered into the tax balance sheet as a fixed asset if they have been acquired against consideration. Self-developed intangibles generally cannot be capitalized. Accordingly, it can be difficult to assess and value any marketing intangibles that might have been created by the German or Austrian distributor. However, the concept of marketing intangibles is accepted in both countries and documentation will be key to tackling this problem. For Germany, it is observed that based on the administrative regulations issued by the Ministry of Finance, year-end adjustments are only accepted if the parties have entered into an agreement prior to executing the transaction. Further, year-end adjustments based on target operating profits are not acceptable if the adjustments are linked to uncertain external price components such as interest rates or price indices. In practice, tax authorities sometimes also accept year-end adjustments even if these conditions are not fully met.

The Austrian position is not as strict, although it also requires a written agreement. The Austrian tax authorities take a position, in line with the EU Joint Transfer Pricing Forum's Report on Compensating Adjustments of November 2013, that year-end adjustments are only accepted if a compensating adjustment is made in the other country as well.

Flagship Store Tax Issues. The predominant issue here is that the purpose of flagship stores is to generate brand value rather than profit. The German and Austrian tax authorities are therefore likely to raise the question of who shall bear the costs associated with the flagship store: the distributor, the brand owner or both? Also, expensive fixtures will have to be amortized over the period of the lease and cannot be treated as current expenditure.

Period of NOLs. In Germany and Austria, consecutive loss periods are generally accepted for a period of no more than three years. However, lately, the Austrian authorities have taken the position that limited risk distributors should not bear any losses. This position can hardly be brought in line with the OECD Guidelines, but has been a constant point of discussion in recent tax audits.

A resulting NOL can be carried forward for an indefinite period of time. Exceptionally, the NOL is cancelled in the event the shares in the loss entity are directly or indirectly transferred to a new owner. This would be the case, e.g., where one MNE is acquired by another MNE. Even in this situation, a safe harbour exists to the extent it can be shown that the NOL entity has undisclosed capital gains on its books. The use of the NOL in future periods is limited by minimum taxation rules in Germany. These provide that only the first 1 million euro and 60 percent of the excess profit for the year can be set off against the NOL, whereas 40 percent of the excess profit above 1 million euro would always be subject to ordinary tax.

Financing/Reclassification. Neither German nor Austrian law has explicit thin capitalization rules for corporate purposes. However, both laws recognize the concept of deemed equity loans, which leads to a reclassification of a loan into equity, if the borrower is in a crisis and no unrelated third party would have granted such a loan. Here, the interest paid will not be deductible for tax purposes. Further, German law provides for the interest barrier, which limits the tax deductibility of net interest expenses by linking the amount deductible to the taxable earnings before interest, taxes, depreciation and amortization (EBITDA). There is a 3 million euro safe harbour for net interest expenses, but this does not apply once net interest exceeds 3 million euro. If this is the case, the entire net interest and certain interest equivalents are only deductible provided they do not exceed 30 percent of the taxable EBITDA. The identity and residence of the creditor to whom interest is paid does not matter. Any interest that cannot be deducted in any given fiscal year can be carried forward subject to the carry forward cancellation rules generally applicable to loss carry forwards. The same carry forward is available for any unused EBITDA volume.

Also, financing provided by low taxed affiliates should be structured carefully. Under Austrian law, interest (and royalty) expenses are not deductible, if the interest is paid to a related entity and if that income is subject to no tax in the hands of the recipient or subject to a low taxation. “Low taxation” in the sense of this provision is any tax rate below 10 percent or if the income is taxed at an effective tax rate of less than 10 percent (i.e., because of certain tax incentives applicable to such income).

2. Tax Controversies

The main points that trigger tax controversies in Germany and Austria, and that are specific to the luxury and fashion industry, are not so different from the issues raised in other countries, and mainly concern marketing intangibles, flagship stores and the comparability of the data used for the benchmark analysis. Other issues, such as NOLs, transfer of functions and limitation of interest expenses, are constant hot topics and not particular to this industry.

Transfer pricing enquiry

German law sets out detailed documentation requirements. The scope varies by company size and, in general, documentation should be established on a contemporaneous basis. For extraordinary business transactions (e.g., transfer of functions) an obligation for timely documentation exists and documentation has to be established, at the latest, within six months after the end of the fiscal year in which the transaction took place. Such an obligation does not exist for ordinary business transactions. There are no clear guidelines as to the date when the documentation has to be in place, but, in general, the statute require taxpayers to present documentation of cross-border transactions with affiliates upon request from the tax authorities (within 60 days upon receipt of the tax authority's request or, in the case of extraordinary business transactions, within 30 days). Where general documents are not provided to auditors in a timely manner, penalties of up to 250,000 euro can be levied. If transfer pricing documentation is either considered to be "essentially unusable" or is submitted late, penalties of up to 1 million euro may be levied. In addition, the burden of proof may shift to the taxpayer and the taxable income may be estimated to the detriment of the taxpayer.

Austrian rules are less strict and the obligation to provide transfer pricing documentation is derived from the general rule to maintain books and records. The Austrian authorities take the view that the documentation should be in place before the tax return is filed; however, there is no legal basis for this approach. Further, in both countries, related parties have to enter into written agreements before carrying out intercompany transactions, to safeguard the deductibility of payments relating thereto.

Whether transfer prices are audited in the course of a general tax audit depends on the acting auditor. However, where intragroup transactions take place, a transfer pricing audit almost always takes place. It will be embedded in the ordinary tax audit, but the transfer pricing issues will be handled by specialists. The duration of an audit depends on the issues at stake and can vary from six months to two years, the latter being exceptionally long.

3. Alternative Dispute Resolution

In Germany, the so called "Fast Track Audit" is available, which means that the taxpayer is audited shortly after the income tax return is filed. A similar procedure is currently being tested in Austria. The use of APAs and the MAP is an important means in both countries. In Germany, unilateral rulings are only available if no double tax treaty applies. In Austria, unilateral binding agreements can be obtained and the tax authorities encourage taxpayers to make use of this option. In both countries, the European Arbitration Convention applies and has proven to be a convincing settlement instrument.

4. International/Regional Concerns

A major current concern in both countries is the transfer of functions and transfer of IP, as well as the valuation of IP. Also, both countries tend to look into the entire value chain of any given transaction and try to allocate additional profit to the local company. The disallowance, or at least limitation, of NOLs is a general pattern seen in both countries as well. Many issues brought up during audit are BEPS influenced and also concern the substance of the related parties, including questions relating to beneficial ownership of IP.

France

Paris is the home of many of the world's most famous and prestigious designers and brands. Hence, the tax issues are most prominent, especially as these brands spread worldwide. While the tax issues in France remain substantively the same for distribution operations, the tax scrutiny for the brands developed by French companies and exploited abroad may be more intense in France. Like most mother countries where the brand is developed, the background detail and the IP development must be clearly examined and understood.

1. Transfer Pricing and Other Issues

Overview of Rules

Statutory rules and administrative regulations. French statutory and administrative approaches to transfer pricing are generally consistent with the principles set out by the OECD. Article 57 of the French tax code (FTC) allows the French tax administration (FTA) to adjust the profits of a French enterprise in a case where the latter has indirectly transferred profits to a foreign associated enterprise by an increase or decrease in purchase or sale prices or by any other means. In a case where it lacks precise elements to support the assessment, the FTA determines the taxable profits by comparison with those of similar enterprises exploited "normally".

Administrative doctrine and case law have constantly interpreted article 57 of the FTC as embodying the arm's-length principle. The FTA needs to demonstrate that the transaction has been concluded on terms that are "unusual". The unusual or abnormal term may be the price or another condition of the transaction (e.g., payment terms). There is a rebuttable presumption of transfer of profits abroad once the FTA establishes the existence and amount of an advantage granted to a foreign associated enterprise.

There is no specific French guidance concerning the selection of the most appropriate transfer pricing method based on the circumstances of the taxpayer. Generally, traditional methods (and in particular the comparable uncontrolled price method) are preferred, although there is no definitive rule in this respect.

Specific rules for Non-Cooperative States and Territories. Non-Cooperative States and Territories (NCSTs) are defined as states or territories that do not belong to the European Union, do not have an administrative assistance convention with France allowing exchange of information as needed to apply the tax legislation of the parties, and have not signed such conventions with at least 12 states or territories. The French list of NCSTs relies on the work of the OECD Global Forum and is updated every year. As of January 2014, the list is as follows: Botswana, Brunei, Guatemala, Marshall Islands, Montserrat, Nauru, Niue and the British Virgin Islands.

Payments made to NCSTs are subject to restricted deductibility conditions and increased withholding taxes as well as other unfavorable measures, including more stringent transfer pricing documentation requirements.

Transfer pricing documentation. To date, the documentation requirements in force or in project are manifold:

- Transfer pricing documentation report (including a "masterfile" and entity-specific documentation) resulting from the combination of the provisions of articles L 13 AA, L 13 AB, L 13 B of the French Tax Procedures Code (FTPC);
- Transfer pricing disclosure form, pursuant to article 223 quinquies B of the FTC;
- Country-by-country reporting, pursuant to article L. 511-45 of the French Monetary and Financial Code;
- Cost accounting and consolidated financial statements, pursuant to article L. 13 of the FTPC.

Difficulty of establishing comparables: Generally, it is possible to identify comparables for manufacturing or distribution activities in the French or European market. The potential development of local intangibles (i.e., know-how for manufacturing, premium location or local marketing intangibles for distribution) must be considered and may require comparability adjustments. In some instances it may even lead to the selection of a profit split method. Regarding trademarks, external comparable analysis may be useful, subject to a thorough examination of the comparability factors, with a special focus on the profit potential. In order to tackle the profit potential issue, and in cases where sufficient financial information is available, it may be appropriate to rely on a comparable profit split analysis. Due to the existence of significant French players in the luxury industry, the French Tax Administration generally has a good knowledge of the industry and, hence, of the comparables available on the market.

Marketing Intangibles Issue for Brands: The main issue regarding brands is how to appropriately allocate the return attributable to the brand between the brand owner and the entities performing marketing and promotional activities in relation to the brand.

There are no specific French administrative guidelines, and case law on this matter is very limited. Depending on the case, the FTA may tend to give more value to the IP ownership or to the marketing activities, keeping in mind that French brands have a strong presence in the luxury industry. In a *Giorgio Armani* case, a French court considered that the French distributing company was insufficiently compensated through the group transfer pricing policy, based on the facts that the French company operated six shops, purchased its products from foreign group companies, incurred heavy expenses (onerous rents, high investment, layout and decoration costs) and assumed advertising costs benefiting foreign companies.[40] The *eBay* case, although it does not directly concern the luxury industry, also gives an indication of the importance given by the FTA and French courts to the legal registration of IPs as compared to their exploitation. A French court judged that the French company eBay France, who held the exclusive right to use a domain name and granted this right to its Swiss parent company without receiving any royalty, did transfer profits abroad within the meaning of article 57 of the FTC, despite the fact that its Swiss parent company had reimbursed the registration costs of the domain name. [41]

The FTA generally follows the OECD Transfer Pricing Guidelines; therefore, the outcome of the current OECD work on the transfer pricing aspects of intangibles[42] will have to be closely monitored.

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[40] Administrative court of Paris, 20 December 2010, Sté Giorgio Armani Retail SRL.
[41] Administrative court of Montreuil, 9 February 2012, Sté eBay France.
[42] OECD revised discussion draft on transfer pricing aspects of intangibles, 30 July 2013.

Flagship Store Tax Issues: A flagship store is a company-owned store that sells a single brand of product and operates to enhance brand awareness, rather than solely to generate profit for the company.

There is no specific French administrative guidelines or case law on this matter. The main question is to what extent the FTA would accept that a French group assumes the costs related to the flagship store of a foreign subsidiary, and conversely that a French subsidiary of a foreign luxury group bears costs arising from a flagship store in France.

Based on precedent, the FTA tends to reject recurring losses incurred by a French distributor of a foreign group, often challenging the entrepreneur characterization of French distributors. In some cases the FTA has claimed that the loss-making distributor provided a deemed service to the benefit of the foreign brand owner. In the opposite situation, where a French group has flagship stores abroad, the French company can assume the related costs, provided it demonstrates that it has decision-making powers over the investment (regarding, e.g., the selection of the flagship store's location) and that the French-owned brand benefits from the investment. Such issues need to be properly addressed in the transfer pricing documentation.

Period of NOLs: Ordinary tax losses can be either (i) carried forward indefinitely in time – in this case, the losses can be offset against taxable profit of a given fiscal year up to an amount equal to 1 million euro plus 50 percent of the taxable profit for the fiscal year; or (ii) carried back one year up to an amount of 1 million euro, subject to certain conditions.

Financing/Reclassification: There is no specific finance rule for the luxury fashion industry, but there are several interest deduction limitation rules that apply in France:

- Interest rate limitation. Interests paid to an affiliated party is tax deductible only within the limit of (i) the interest rate computed with reference to the average floating rate of loans with a maturity exceeding two years granted by banks to enterprises (as published on a quarterly basis by French authorities); or (ii) market rate (if higher).
- Hybrid mismatch anti-abuse rule. Interest deduction is allowed only if the French borrower demonstrates that the lender is subject to corporate tax on the interest income that equals 25 percent or more of the corporate tax that would be due under French tax rules.
- Thin capitalization rules. Interests paid to an affiliated party that exceed the highest of the three limits below are disqualified: (i) interest exceeding a debt/equity ratio of 1.5:1; (ii) interest exceeding 25 percent of the borrowing company's adjusted operating profits before tax; (iii) interest exceeding the amount of interest received from related entities. Please note that financings (including bank loans) secured by a "related party" may fall under the scope of French thin capitalization rules. Disqualified interests can be rolled over, with a 5 percent rebate after the second fiscal year.
- General interest deduction limitation. This limitation applies to companies whose net financial expenses exceed a 3 million euro annual threshold. When exceeded, interest deduction is limited to 75 percent of the net financial expenses.

2. Tax Controversies

The main issues that can arise during a tax audit are not specific to the luxury and fashion industry and are quite similar to the issues raised in other EU countries, such as: levels of return and risk for flagship stores, marketing intangibles, loss-making routine functions, limitation of interest expenditures, IP transactions (transfer of IP, royalties) and business restructurings.

Transfer Pricing Inquiry

There are no specific transfer pricing audit procedures in France. Transfer prices are thus audited as part of a regular corporate income tax audit (while not systematic, a tax inspector will frequently review whether transfer pricing rules are correctly applied) and under the usual statute of limitation applicable to corporate income tax (i.e., 31 December of the third year following the year during which a fiscal year is closed). Please note that fiscal years that generated tax losses can be audited after the three-year period to the extent said tax losses have been offset against tax profits of a fiscal year open to tax audit. Multinational companies are generally audited every three to four years unless in a loss-making situation (indeed, in such cases, the statute of limitation rules are less crucial to French tax authorities, as explained above).

Typically, a tax audit would be carried out as follows:

- A tax audit notice (*avis de verification*) is sent to the taxpayer, informing it of the date of the tax inspector's first onsite visit, and the taxes and years under investigation.
- The tax inspector's onsite visit takes place at the taxpayer's main premises (registered offices or main place of business). Generally speaking, the transfer pricing documentation (if applicable) and, as of 1 January 2014, the Accounting Entries File (AEF) will be requested by the tax inspector during the first onsite visit. Please note that, outside small and medium-sized enterprises (SME)s, there is no statutory maximum limit to the time the tax auditor may spend onsite. Also, the tax auditor can be assisted by IT Specialists and/or Transfer Pricing Specialists (particularly when the audit is carried out by the National and International Audit Department).
- Throughout the tax audit, a dialogue takes place between the taxpayer and the tax inspector, and onsite investigations are finished when all outstanding questions have been answered.
- A tax reassessment notice (*proposition de rectification*) is sent to the taxpayer, informing it of the adjustments and tax penalties (if any).
- The taxpayer can either accept or reject the tax reassessment notice by submitting written arguments to support its position. In the latter case, the taxpayer is entitled to further request a meeting with the tax inspector's superior (*supérieur hiérachique*) and with the local head of the tax audit department (*interlocuteur départemental*) to discuss the reassessments. Subsequently, French tax authorities can either uphold or amend the initial position. Where a reassessment is maintained, the taxpayer can further request a hearing before the *Commission Départmentale* for the review of technical issues (as opposed to legal issues), given that transfer pricing issues generally fall within the jurisdiction of this administrative body. It should be noted, however, that the decision of the *Commission Départementale* is not legally binding on the French tax authorities.
- After receipt of the tax collection notice, a tax claim must be filed with the tax authorities (within the applicable claim period) prior to any court litigation. Upon issuance of a rejection notice (or, in the absence of a formal answer from French tax authorities, within six months of the filing of the claim), then the taxpayer is entitled to take the case to the

administrative court (*tribunal administratif*). Either party can subsequently appeal the decision before the administrative court of appeal (*cour administrative d'appel*) and the French Supreme Administrative Court (*Conseil d'Etat*).

3. Alternative Dispute Resolutions

MAPs

The taxpayer is allowed, irrespective of whether litigation is pursued or not, to initiate a mutual agreement procedure pursuant to the relevant double tax treaty or the European Arbitration Convention.

APMAs

While the FTA has expressed a strong preference for bilateral APAs, unilateral APAs represent 32 percent of the total APAs, according to the FTA's statistics in 2014. According to its statistics, there were 17 APAs cases opened in 2013.

France has concluded over 120 bilateral tax treaties containing a MAP article (the French competent authorities may refuse to open a MAP in specific cases[43]). For intra-European transfer pricing cases resulting in double taxation, a MAP can also be initiated under the European arbitration convention.[44] The taxpayer may submit its request under both procedures simultaneously. According to the French tax authorities, the average duration of the procedures is 22 months for an APA and four years for MAP. According to the FTA's statistics, in 2013 there were 161 opened cases and 161 closed cases. MAP procedures that were opened before 31 December 2013 suspended the tax collection until the expiration of a three-month period after the notification to the taxpayer of the position of the competent authorities. This provision has been abrogated by the Finance Act for 2014 for MAP procedures opened after 1 January 2014.

4. Regional Concerns

France is a member of the EU. It actively participates in the work of the EU Joint Transfer Pricing Forum, which assists and advises the European Commission on transfer pricing tax matters, within the framework of the OECD Transfer Pricing Guidelines, and operates on the basis of consensus to propose to the Commission pragmatic, non-legislative solutions to practical problems posed by transfer pricing practices in the EU.

National tax administrations of the EU also cooperate and exchange information and expertise through the Fiscalis programme.

Italy

Italy is a major market for the luxury and fashion industry's products and services as: (i) Italy and its cities is considered by international travelers one of the preferred destinations for tourism and shopping; (ii) these destinations offer a relevant presence of the main international brands and

[43] Absence of demonstration of double taxation, application of serious penalties, self-adjustment of the double taxation by the taxpayer.
[44] Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises signed on 23 July 1990.

designers and a great number of Italian brands; and (iii) “made in Italy” is very attractive to the luxury and fashion markets around the globe.

1. Transfer Pricing and Tax Controversies

Since the enactment of the EU Code of Conduct and Transfer Pricing documentation regulation in mid 2010, the Italian tax authorities (ITA) have increased the tax audit activities in this industry, by looking more closely at the transfer pricing policies, license arrangements, foreign locations of IPs, and possible permanent establishment status.

Particularly for this industry, the ITA actively audit the effective place of management and tax residency of foreign operations to levy Italian tax on foreign income (for trading and/or royalties). Here, the *Dolce & Gabbana* case had a significant echo in the local and international tax practice.

Black-list and Controlled Foreign Company (“CFC”)regulations. Another particularity of the luxury and fashion industry is the location of several international suppliers, wholesale customers and distribution centers in low tax jurisdictions. This circumstance falls within the scope of the following tax regulations that are carefully scrutinized by ITA during tax audits:

- The so called “black-list” costs for transactions concluded with entities based in low-tax jurisdictions and the anti-tax haven provisions. Here, the deduction of the costs incurred by an Italian company in transactions with companies located in low-tax jurisdictions may be disregarded unless the Italian entity establishes that (i) the transactions were actually carried out and the actual business carried out by the foreign company; or (ii) the transactions were justified by the occurrence of a business purpose.
- Profits realized by a foreign entity are deemed under the Italian CFC rules to be the profits of an Italian company owning a relevant interest in the foreign entity if the latter is resident in a privileged tax jurisdiction or takes advantage of a privileged tax regime. As a consequence, without a complex tax ruling protection, the foreign income is immediately taxed in Italy on an accrual basis regardless of whether these profits are distributed to Italy.

Marketing Intangibles. A current phenomenon in Italy relevant to this issue concerns the migration and the centralization of marketing intangibles together with the attendant IPs and brands generated in Italy to enhance the perception of international brands (e.g., FIAT) and achieve a coordinated global management of IP, and avoid a separation of the IP for tax reasons.

Transfer Pricing and Other Issues

Overview of Rules. The Italian transfer pricing regulation follows the OECD Transfer Pricing Guidelines, but with minor deviations regarding the hierarchy of the transfer pricing methods. Although the TNMM has become the most applied method in APAs, traditional methods are still the preferred methodologies of the ITA in tax audits and tax controversies.

The Law Decree n. 78/2010, converted into Law n. 122/2010, as well as the Documentation Regulation of 29 September 2010, establish documentation requirements for transfer pricing purposes.[45] This legislation provides that enterprises, which conclude transactions with foreign

[45] Clarifications on transfer pricing regulation are also contained in the Provision of the Director of the Italian Tax Authority dated 29 September 2010 and in the Circular Letter 58/E issued by the ITA on 15 December 2010.

companies belonging to the same group, may prepare transfer pricing documentation and flag a specific box in the tax return, indicating the availability of the transfer pricing documentation. If the documentation is assessed as adequately informative, the taxpayer may be granted penalty relief from transfer pricing adjustments.

Under article 110 (7) of the Italian Income Tax Code, only transactions between an enterprise resident in Italy and a foreign enterprise, where both entities belong to the same multinational group, are relevant for transfer pricing purposes.

Transfer Pricing Methods

The transfer pricing methods in the OECD Guidelines are fully accepted by the Italian transfer pricing legislation. In particular, the transfer pricing provisions dated 29 September 2010 directly refer to the OECD Guidelines and incorporate the definitions of the “traditional transactional methods” (also referred as “traditional methods”) and the “transactional profit methods” (also referred as “transactional methods”).

The OECD Guidelines revised in 2010 no longer specify a hierarchy of methods. However, as provided under par. 2.3, where a transaction-based method (i.e., CUP, re-sale price or cost plus) and a profit method (profit split or TNMM) are both equally reliable, the traditional method is preferable. Similarly, where a CUP method and another transfer pricing method are both equally reliable, the CUP method should be used. Under the Italian rules, taxpayers must clarify the reasons for excluding a traditional method (in case it is excluded).

Transfer Pricing Penalties

In the event of transfer pricing adjustments, administrative penalties can be avoided if adequate transfer pricing documentation is prepared. These penalties may otherwise range from 100 percent to 200 percent of the higher tax applied.

Difficulty of establishing comparables

Where the tested party is an Italian distribution company within the luxury and fashion industry, it generally carries out other relevant activities beyond distribution, including advertising, marketing and promotion. These “ancillary’ activities are often indirectly remunerated through a discount policy on the product price or on the royalties, which allows the distributor to target a return on sales (“ROS”) in line with its functions performed.

In performing a comparability analysis, Italian regulation and the ITA rely on stringent application and detailed assessment of the five OECD comparability factors (characteristics of goods and services, functional and risk analysis, contractual terms, economic circumstances and business strategies). Independent distributors are generally accepted if they perform comparable activities. In addition, working capital adjustments can be made to correct certain comparability defects. In its selection of comparables and benchmark analyses, the ITA are increasingly taking a more “technical’ approach to transfer pricing documentation.

For selecting the final set of comparables, the ITA usually do not use pan-European comparables or multiple databases because they could operate according to very different logistics. If the ITA disregard the selection of comparables presented by the company, they usually conduct a totally new benchmark analysis. When the ITA carry out a benchmark analysis, the following search criteria are usually used:

- Absence of operating losses: the ITA's final set of comparables usually only includes companies that have not incurred operating losses during the fiscal years being assessed;
- Minimum turnover: the ITA usually apply a "filter" related to the level of revenues;
- Employees/turnover ratio: this ratio is sometimes applied by the ITA to assess the level of comparability of companies.

Where the tested party is the owner of the licensed brand, the benchmark analysis is based on a search through a database containing information on commercial agreements (generally, *RoyaltySource*). Finally, the ITA generally use in tax audits and tax settlements Italian comparables, as opposed to pan-European data.

Marketing Intangibles Issue for Brands

The cross-border transfer of marketing intangibles are assessed in depth by the ITA. Italian regulation, as well as the OECD Guidelines, relies on the valuation of the intangible based on the most reliable estimates and assumptions available at the time of the transfer, rather than on a hindsight view. However, the ITA may disregard these estimates if actual results show a significant deviation.

Finally, it is observed that the first domestic guidelines (dated 22 September 1980) provided for safe harbors for royalty payments (with rules regarding rates of 2 percent, up to 5 percent, and over 5 percent). These regulatory results are, however, out of date and obsolete, given also their exclusion from the sources of recent transfer pricing regulation. However, the ITA still opportunistically refer to these provisions in tax assessments.

Flagship Store Tax Issues

Generally, flagship stores can be in a loss position given the high operating expenses resulting from their exclusive locations. The ITA often question which entity in the group should bear these losses. A principal function of a flagship store is to strengthen brand awareness and visibility, hence enhancing brand value rather than generating retailing profit. Accordingly, ITA usually argues that these losses should be borne by the brand owner as promotion expenses.

Italian brand owners with flagship stores in other countries generally run these stores by means of foreign branches of the Italian parent company. This allows the Italian entity to deduct the losses of the flagship stores for Italian tax purposes.

Period of NOLs

There are precise rules that limit the period during which an Italian entity can report NOLs. Starting from the second fiscal year, the Italian entity must report a minimum amount of revenues and proceeds that is computed in proportion to the book value of the assets owned. If the entity does not achieve this minimum amount of revenues, it must report also a minimum taxable income that impairs the actual operating loss. After three years with operating losses, the company must report a minimum taxable income if it has reported an amount of revenue in line with the official statistical date stated by the ITA. As a remedy, companies unable to meet these requirements can file an advanced tax ruling.

In the tax audit program, tax officers also are required to perform a tax audit of companies that have reported NOLs for more than two subsequent years. Here, the ITA frequently take the position that limited risk distributors should not bear risks and should report income yearly.

Financing/Reclassification

Intercompany financing arrangements fall within transfer pricing, and the arm's-length terms of interest rates are scrutinized by the ITA. In addition, overdue receivables shall be generally remunerated with the application of interest.

Value-added Taxes and Customs Duties

Value-added Taxes

In the luxury and fashion industry, suppliers of products and services are normally subject to the standard 22 percent VAT rate; the two reduced VAT rates of 10 percent and 4 percent apply on specific transactions.

In doing business in Italy, the foreign company should carefully consider the complex Italian VAT formalities of invoicing (with special requirements in terms of format and information provided), accounting and reporting (such as filing of the Intrastat forms and transaction with suppliers resident in low-tax jurisdictions). The form and content of invoices, as well as the validity of the VAT identification number and other details of the recipient, should be checked and validated periodically. The correct VAT treatment on invoices received shall be carefully identified by the recipient to avoid any deduction issue.

Year end adjustments, made according to transfer pricing policies, are qualified for VAT purposes as amendments of the taxable basis, and may trigger VAT obligations. Generally, any adjustment of the price payable for a good or a service results in the adjustment of the assessment base for VAT purposes. However, while downwards adjustments (resulting in a lower taxable basis) can be voluntarily recorded by the original supplier, upwards adjustments (resulting in an increase of the taxable basis and, therefore, of the VAT amount due) shall be mandatorily reported through the issuance/recording of a debit note (and payment of the higher VAT) or through the amendment of the customs import declaration.

This level of compliance also makes it very complex for the e-commerce business to be managed directly by the foreign merchant.

Customs duties

The importation of goods also triggers customs duties in the country where the goods are customs cleared for free circulation within the European Union. While discussed in more detail in Chapter 12 customs duties typically apply on the importation of fabrics and raw materials (e.g., furs and leather) coming from extra-EU countries. The exportation of goods from Italy to an extra-EU country generally does not trigger the application customs duties (or VAT). The authorized temporary introduction of goods in Italy for processing purposes is normally exempted from customs duties. Similarly, the reintroduction in Italy of goods temporary exported (upon authorization) for processing purposes (i.e., for handwork activities to be done in countries where labor costs are lower) should be partially or totally exempted from the payment of customs duties. Careful management of import and export is necessary to prevent the cost of products to be subject to customs from exceeding two or even more times being sold to final customers.

2. Tax Controversies

Tax audits normally cause a high decree of concern to the management of Italian companies due, to (i) the lengthy and demanding procedure carried out by tax auditors; (ii) high penalties charged for tax violations; and (iii) possible personal criminal implications.

The main tax adjustments and tax controversies related to the luxury and fashion industry are: (i) transfer pricing; (ii) deduction of costs and expenses for transactions with entities located in black-list countries; (iii) CFC rules applied to entities located in low tax jurisdictions; (iv) valuations on the migration of IP; (v) permanent establishment mainly in respect to limited risk distributors, commissionaires and agents; (vi) effective place of management and tax residency of foreign subsidiaries or affiliated companies.

The involvement of the competent authority in the resolution of tax disputes involving transactions that arise with foreign entities is becoming more frequent as a way to avoid double taxation. The Italian Revenue Agency issued a Circular Letter (no. 21/E of 2012) to improve the recourse to the MAP or the Arbitration Convention as a possible remedy to eliminate double taxation.

Competent Authority

All Italian double taxation treaties contain the competent authority process clause under article 25 of the OECD Model Treaty (the so-called MAP). However, only few competent agreement procedures have been carried out. Article 110 of Italian Income Tax Code allows the Italian tax authorities to make corresponding adjustments to the Italian taxpayer's income as a consequence of a reallocation of income by a foreign taxing authority, only to the extent that an agreement between the two competent authorities under the competent authority process has been reached. We note that the Italian competent authority has started reviewing cases with the U.S. and it is expected that the first joint meetings will commence soon.

Arbitration Convention

Where two competent authorities fail to reach a mutual agreement, the EU Arbitration Convention no. 436/1990 provides for a specific arbitration procedure dealing with correlative adjustments arising as a result of a transfer pricing adjustment against EU companies. The Arbitration Convention has been a way to eliminate double taxation at the EU level.

Russia

Introduction

Russia is a fast-growing market for many of the biggest names in the luxury and fashion industry, with many groups operating stores in Moscow.

In recent years, we have increasingly seen the Russian tax authorities taking an interest in the tax deductibility of royalty payments paid under license agreements by Russian companies to foreign licensors.

As far as marketing intangibles are concerned, the pricing models we most commonly see are (1) licensing of the brand (the trademark/service mark, the trade name and/or other intellectual property) to the Russian retail operator, who pays a royalty for use of the granted intellectual property rights and sources the products from affiliates of the brand owner, having such relations regulated by virtue of franchise/license agreements and distribution/supply agreements; and (2) principal-type-structure, with the brand owner selling the product directly to its local affiliates or the Russian third-party retail operators by virtue of distribution/supply agreements with no remuneration for use of the brand with regard to the product, due to the exhaustion of trademark rights. In the latter case, if the local affiliates or the Russian third-party retail operators operate their stores under the brand, the respective trademark (service mark) registered and protected in Russia in connection with retail services is licensed by the brand owner to the retail operator under a license or franchise agreement, in return for certain license or franchise fee payment.

1. Transfer Pricing and Other Issues

Overview of rules. The new Russian transfer pricing legislation, applicable since 1 January 2012, generally follows the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. The new rules require taxpayers to notify the tax authorities of controlled transactions that are performed in a given calendar year. Controlled transactions include any transactions between related parties (domestic or cross-border). Among other criteria, parties are considered related if one directly or indirectly owns more than 25 percent of another, or can control the formation of at least 50 percent of the board of directors or the executive body of such other party. The courts may also determine that parties are related if the relationship between them could affect the results of transactions between them or their economic activities, even in the absence of the statutory criteria. In addition, cross-border transactions with non-related foreign entities registered in certain low-tax jurisdictions, according to the list established by the Russian Finance Ministry (consisting of offshore jurisdictions), are subject to Russian transfer pricing rules, provided that the total revenues under these transactions exceed RUB 60 million (approximately US$1.7 million) in total in a given calendar year. Currently, there are proposals to exclude the RUB 60 million threshold from the Russian Tax Code, making all transactions of Russian companies in the low-tax jurisdictions on the list established by the Russian Finance Ministry subject to Russian transfer pricing rules.

With certain exceptions, the following domestic transactions are not subject to transfer pricing control:

- transactions between related parties not exceeding RUB 1 billion (approximately US$28.6 million) in total in a given calendar year; and
- transactions where both parties are registered and conduct all operations in the same region and do not have tax losses, including loss carry-forwards.

Also, Russian taxpayers forming a consolidated taxpayer group are not subject to the transfer pricing control for corporate profits tax purposes.

Establishing comparables. The new rules provide for five transfer pricing methods (comparable uncontrolled price, resale, cost plus, comparable profits and profit splits). The comparable uncontrolled price method is the primary method to be applied. In all other cases, the best method rule generally applies.

The new rules provide detailed guidance on selecting and adjusting comparables. There is a broad list of permitted data sources on comparables. The rules prohibit the tax authorities from using any outside comparables if the taxpayer has comparable transactions with unrelated parties.

Adjustments are permitted, inter alia, with respect to corporate profits tax and VAT (if one of the parties does not pay VAT). In certain cases, taxpayers are permitted to make true-up adjustments for previous tax periods. Corresponding adjustments (i.e., in case a transfer pricing adjustment is made to another party of a controlled transaction) are allowed for Russian corporate taxpayers only. In a cross-border context, such adjustments are not allowed.

Taking into account that it has been only two years since the new transfer pricing rules came into force, court practice has not yet been established. Therefore, certain difficulties in establishing comparables directly connected to the luxury and fashion industry are yet to be determined.

Cost allocation agreements. Russian transfer pricing rules do not provide for income shifting and cost allocation under cost sharing or similar arrangements.

Marketing Intangibles Issues for Brands. As mentioned above, different issues will arise depending on the structure that is used. One particular tax issue a Russian company will need to consider is whether it is able to amortize expenditure on the brand. From the Russian IP standpoint, qualification of the IP asset transferred would depend on the particular list of IP rights to the agreement (e.g., know-how, copyrights, industrial designs). The Russian tax law provides that the results of intellectual activities and rights to intellectual property (including know-how) owned by the taxpayer (in practice, this means intangibles acquired under a full assignment of the IP rights or under an exclusive use license providing for a lump sum payment), which (i) are used in production of a company for more than 12 months; (ii) have an initial value of more than RUB 40,000 (approximately US$1,140); and (iii) are properly documented, are classified as intangible assets subject to amortization. Royalties paid under license agreements generally may be deducted by the Russian company as expenses for corporate profits tax purposes.

Flagship Store Tax Issues. We have not identified any particular risks that may arise in connection with opening flagship stores in Russia. Fit-out costs are deductible for Russian corporate profits tax purposes, either through asset depreciation or as a lump sum in the tax period when the costs occurred, depending on the particular scope of fit-out works. If fit-out works constitute major reconstruction of the premises (e.g., construction/destruction of walls), then the costs incurred may be deductible for Russian corporate profits tax purposes through asset depreciation. Tenants may also deduct fit-out costs in case the costs are not reimbursed by the owner of the premises. In order to avoid claims from Russian tax authorities with regard to deduction of fit-out costs, it is recommended tenants (a) conclude a long-term lease agreement that is subject to state registration (if a tenant concludes a short-term lease agreement (for less than a year), it may not be able to continue asset depreciation in case of renewal of the lease agreement); and (b) receive in advance the owner's consent to conduct fit-out works in the premises.

Period of NOLs. Losses may be carried forward for 10 years. There is no requirement to spread the loss over the entire carry-forward term; as well, as there is no limit on the amount of taxable profit that can be reduced by a loss carry-forward in a particular year. In addition, capital losses may be offset against operating income; this deduction, however, must be evenly spread over the residual useful life of the capital asset for which the loss was incurred.

Value Added Tax. VAT is imposed on all goods imported into Russia and is also applied to the sale of goods, work and services. The tax period for VAT for all taxpayers and tax withholding agents is a calendar quarter. Taxpayers must pay VAT in equal installments not later than the 20th day of each month following the reporting quarter. Current legislation imposes a general VAT rate of 18 percent on the sale of most goods, work and services. In addition, certain types of goods, work and services are exempt from VAT, including, but not limited to, the following:

- land plots, and lease of office space to accredited representative offices and branches of foreign legal entities from jurisdictions that apply reciprocal benefits;
- the sale of shares, derivatives and repo transactions;
- the assignment of exclusive IP rights (e.g., patents, know-how), with the exception of trademarks, and rights to use the results of these IP rights (e.g., a software use license) based on licenses (including non-exclusive licenses).

Generally, VAT paid on the acquisition of goods, work and services may be offset against VAT collected from customers. Russian buyers are not required to postpone offsetting input VAT on advance payments until the goods, work and services are delivered and can take an offset on special advance VAT invoices. Russian VAT legislation allows recognition of retroactive discounts in the current tax period through issuing corrective VAT invoices (however, if a discount does not change the price set in a contract, the taxpayer does not need to issue a corrective VAT invoice). In May 2012, new e-invoicing regulations came into force. E-invoicing requires a digital signature and data transfer via authorized operators and is subject to the agreement of the counterparties.

An enterprise ends up transferring to the state only the difference between input VAT paid and VAT collected. As a general rule, however, a taxpayer may not offset input VAT if such VAT is incurred on goods, works or services used by the taxpayer for the sale of goods or the provision of services that are exempt from VAT. In this case, the taxpayer will be required to maintain separate accounting for its VATable and non-VATable transactions, and include such input VAT relating to non-VATable sales in its production costs, and will effectively lose this input VAT for future recovery. In those cases where only a portion of certain input costs was used for the production of goods or the provision of services subject to VAT, the corresponding input VAT may be offset only on a pro-rata basis.

Foreign legal entities having more than one representative office and/or branch registered in various locations in Russia may consolidate all VAT accruals and offsets on a company level. For that purpose, a foreign legal entity must choose a particular representative office or branch to be responsible for VAT reporting on a company level, and notify the local tax authorities responsible for each representative office and branch registered in Russia of its decision.

Cross-border services, such as licensing IP or know-how, unless exempt from VAT, and the provision of workforce or design services, are generally subject to the reverse charge system. A Russian customer of a foreign company that is not registered with the tax authorities and is active (making sales or providing services) in Russia must withhold 15.25 percent ((18/118)*100 percent) reverse charge VAT from the amounts transferred to the foreign company and must itself remit such reverse charge VAT directly to the state budget.

As of 1 January 2014, VAT tax returns may be filed with the tax authorities only in electronic form.

Financing/Reclassification. There is no specific finance rule for the luxury/fashion industry, but there are certain anti-avoidance rules the group should take into account. These are:

- Interest deductibility rules. Generally, under the Russian Tax Code, interest is deductible for tax purposes as long as it does not deviate by more than 20 percent from market interest rates paid on comparable loans in the same calendar quarter. Any excessive part of the interest is not deductible. If no such comparable loans exist (or at the choice of a taxpayer), interest is deducted within certain limits. For the tax period of 2014, deductible interest for ruble loans may not exceed a factor of 1.8 of the Russian Central Bank refinancing rate (i.e., 14.85 percent at the currently effective 8.25 percent refinancing rate), and for loans denominated in a foreign currency, the deduction is limited to a factor of 0.8 of the Russian Central Bank refinancing rate (i.e., 6.6 percent at the currently effective 8.25 percent refinancing rate) per annum.

In addition, interest deductibility limits in loan agreements concluded between related parties are also determined in accordance with the Russian transfer pricing rules. Starting from 1 January 2015, the interest deductibility limits will apply only to borrowings that are qualified as “controlled transactions” for transfer pricing purposes. Safe harbor limitations will apply if one of the parties to a controlled transaction is a bank. The safe harbor range would depend on the loan currency.

- Thin capitalization. This restricts deductible interest expense for a Russian resident company on a loan from a foreign shareholder holding more than a 20 percent interest in the Russian borrower company (including debt owed to a Russian affiliate of the foreign shareholder and debt guaranteed by the foreign shareholder or its Russian affiliate) if the ratio of the Russian borrower company’s internal capital to its outstanding debt owed to the debtor exceeds a 3:1 ratio limit. Non-deductible interest is also considered to be a dividend payment to the foreign shareholder and hence is subject to a 15 percent withholding tax, unless the latter is reduced or eliminated by an applicable tax treaty. The limitation is recalculated at the end of each quarter.

  While under the plain language of the thin capitalization rule, it does not formally apply to debt from foreign sister or foreign affiliated companies (i.e., foreign companies not in the ownership chain) or from Russian legal entities affiliated to such companies, various Russian court decisions have added a gloss to the language of the Russian Tax Code and started to apply the thin capitalization rule to such loans.
- Anti-avoidance rules. These (“unjustified tax benefit doctrine”, “substance over form doctrine”, “sham transaction doctrine”) apply in order to deny a tax deduction or application of tax benefits, including those provided for under a double tax treaty concluded by the Russian Federation (e.g. reduced royalty tax rate), where a legal entity subject to Russian corporate profits tax is a party to a scheme the main purpose, or one of the main purposes of which, is to achieve a Russian tax advantage.

2. Tax Controversies

The main points to be aware of from a Russian perspective are the application of new transfer pricing rules (court practice not yet having been established), anti-avoidance rules and the restrictions on interest deductibility.

Transfer pricing enquiry

Taxpayers having controlled transactions (with certain exceptions) are required to maintain transfer pricing documentation and provide it to the tax authorities within 30 days of the relevant request. The transfer pricing documentation may be requested no earlier than 1 June of the year following the calendar year in which the relevant transactions took place. The rules do not establish clear criteria for determining the exhaustive list and contents of the documentation. The general requirements are: primary accounting records, tax ledgers, tax adjustment records (if applicable), records of transactions with associated businesses to which the transfer pricing rules apply and evidence to demonstrate an arm's-length result.

In most cases, the enquiry would be expected to last no longer than six months. However, a longer timescale (but no longer than 12-15 months) may apply in exceptional cases that are particularly complex and require the obtaining of information from foreign tax authorities.

3. Alternative Dispute Resolution

Generally, there is no alternative dispute resolution procedure in Russia. At the same time, Russian legislation provides for an obligatory pre-trial administrative appeal and for a limited possibility of concluding an advance pricing agreement.

Obligatory pre-trial administrative appeal. As of 1 January 2014, taxpayers that wish to challenge a decision on the results of a tax audit conducted by the Russian tax authorities are required to use a pre-trial administrative appeal procedure (the only exception is for acts adopted directly by the Federal Tax Service). According to the official statistics of the Russian tax authorities, in 2013 about 37 percent of administrative appeals were won by taxpayers. However, we note that in 2013 the taxpayers were mostly not required to file an administrative appeal. In the majority of cases, the local tax inspectorates base their decisions on policies adopted at higher levels; therefore, the likelihood of obtaining a positive decision from an administrative appeal may still be limited.

Advance Pricing Agreements. Taxpayers that are regarded as major taxpayers under the Tax Code (i.e., the amount of federal taxes paid in one of the last three years exceeds RUB 1 billion (US$28.6 million), the annual income or the amount of assets of the taxpayer exceeds RUB 20 billion (US$571 million)) are permitted to enter into with the Russian Federal Tax Service unilateral or multilateral APAs of up to three years with a possibility to extend to five years. The new rules enable taxpayers to conclude APAs covering cross-border transactions with a party resident in a state having a double tax treaty with Russia under the competent authority's procedures with the participation of the relevant foreign tax authority. In the event of changes in the Russian rules covering APAs, the terms of the concluded APAs are grandfathered.

Mutual Agreement Procedure. Russia does not publish any information on MAP cases or relevant statistics data, and it is difficult to determine the actual number of MAP cases in Russia. In general, compared with European jurisdictions, MAP cases are quite rare in Russia, mainly due to the fairly undeveloped tax rules. However, as a result of the growing complexity of the Russian legislation, and the tax authorities recently having taken a more aggressive approach to the justification of taxpayers' activities and expenses, there has been a visible increase in the use of MAPs in Russia. Double tax treaties concluded with Russia vest competent authority functions on the Russian Ministry of Finance. In general, the approach adopted by the Russian tax treaties is to provide for cases to be presented by a resident of a Contracting State to the Competent Authority of the Contracting State of which the person is a resident.

4. International/Regional Concerns

A major current concern is the tax treatment of royalties paid under license agreements by Russian companies to foreign companies. Current areas of focus for the Federal Tax Service are: (1) the business purpose of royalty payments; (2) the rate of royalties under license agreements concluded by the Russian company with a foreign company and the substance of these agreements; and (3) the application of the beneficial ownership concept in the case of application of double tax treaty benefits.

Starting from 1 September 2016, companies that collect personal data of Russian citizens are required to maintain databases, e.g., electronic commerce, sale of goods online, for the purpose of storage and processing of such personal data on Russian territory. The new rules do not expressly require that operations with the personal data of Russian citizens be performed solely using Russian databases, and do not additionally restrict cross-border personal data transmission. Based on the literal interpretation of the new rules, Russian databases may simply be used within already existing data processing routes and facilities. At the same time, due to the ambiguity of the wording of the new rules, law enforcement practice may potentially develop in a more restrictive manner. Furthermore, in the long term, operators of the relevant websites might face the risk of a "server-based" taxable permanent establishment in Russia.

B. America Region

Mexico

According to a market analysis, the luxury and fashion industry has enjoyed dynamic growth in Mexico. The market also has seen significant company activity, with new luxury brands entering the Mexican market for the first time. This can be explained, in part, by foreign companies diversifying their sources of income by expanding to emerging markets, as well as the internal growth of Mexico's economy.

The luxury and fashion industry's products still have a great deal of potential in Mexico because customers are becoming increasingly aware of the advantages that these products offer in terms of quality, performance and status. Several reports estimate that more than 5 percent of Mexico's population has access to luxury products, and this number will increase with the country's expected economic growth, and the increase in credit extended to consumers.

In Mexico, around 40 million people between the ages of 25 and 50 are the target consumers of companies in the luxury and fashion industry, given that they are income-earning individuals with higher consumption needs and greater interest in fashion trends.[46]

1. Overview of the Transfer Pricing Rules

Like the relevant legislation in many other countries, the Mexican Income Tax Law (MITL) follows the OECD Guidelines. In 2002, these Guidelines officially became the primary guidance for the interpretation of the application of the Mexican transfer pricing statutes. The MITL requires that taxpayers conducting transactions with related parties determine their cumulative

[46] *Forbes* article, July 2013.

income and authorized deductions, by taking into consideration the prices or amounts that they would have agreed upon with non-related parties in comparable transactions, and to prepare and maintain annual documentation to support it. Under article 76, section IX of the MITL, all taxpayers have the obligation to prepare and maintain contemporaneous documentation proving that the transactions carried out with related parties residing abroad or with companies residing in tax havens are pursuant to the arm's-length principle. A transfer pricing study must be conducted each tax year, and should contain an evaluation by each type of transaction.

Taxpayers should consider the following elements in determining comparability: i) characteristics of the transactions; ii) functional analysis; iii) contractual terms; iv) economic circumstances; and v) business strategies.

The MITL also indicates that the following factors should be taken into account when analyzing transfer pricing issues involving intangibles:

- type of transaction (license or sale);
- type of property (patents, trademarks or technology);
- remaining useful life of the intangible asset; and
- level of protection.

Once the comparability factors are considered, the most reliable transfer pricing method must be applied, which, under the facts and circumstances, provides the most reliable measure of an arm's-length result. The six methods established in article 180 of the MITL, which are the same methods included in the OECD Guidelines, are the following:

- comparable uncontrolled price;
- resale price;
- cost plus;
- profit split;
- residual profit split; and
- transactional net margin

In 2006, the MITL introduced a hierarchy for the application of transfer pricing methods. In particular, article 180 of the MITL establishes that taxpayers may use another method only when the CUP method is not appropriate to determine the arm's-length nature of the tested transaction, in accordance with the OECD Guidelines.

The taxpayer must show that the method used is the most appropriate or most reliable pursuant to all available information, giving preference to the resale price or cost plus method over the profit split or transactional net margin methods.

To determine the price that should be used between independent parties, article 180 of the MITL allows the use of a range of prices or profit margins resulting from the use of a method with two or more comparable transactions. This range may be adjusted through statistical methods (e.g., interquartile range).

The MITL also establishes rules for applying reasonable adjustments to eliminate differences among the comparable transactions or companies. These adjustments must consider the comparability elements previously mentioned. Here, a common practice of the Tax Administration Service (*Servicio de Administración Tributaria* (SAT)) is to accept working capital adjustments such as differences in accounts payable, accounts receivable, inventories and fixed assets adjustments.

According to article 180 of the MITL, when using financial information (e.g., revenues, costs and expenses) to demonstrate that intercompany prices are agreed at market prices, the taxpayer must prepare that information according to Financial Reporting Standards.

Difficulty of establishing comparables. Public financial information for local comparables is limited in Mexico. Therefore, SAT allows taxpayers to use foreign comparable data. As a result, a taxpayer may use foreign company data in the absence of local reliable comparable data.

Under article 69 of the Federal Tax Code (*Código Fiscal de la Federación* ("FFC")), SAT may use confidential information obtained from third parties to benchmark the cumulative revenue, income, and authorized deductions of taxpayers that have not conducted their transactions under the arm's-length principle.

In a comparability analysis related to intangibles, it may sometimes be difficult to find comparable transactions involving these assets, so it may be necessary to use transfer pricing methods not directly based on comparables, including, e.g., profit split methods and valuation techniques.

Marketing Intangibles Issue for Brands. Due to the operating model (e.g., limited risk distributors) of the Mexican subsidiaries in the luxury and fashion industry, intangible assets (e.g., brand or trade name) generally are not owned by Mexican entities; however, some subsidiaries carry out marketing expenditures to develop "brand" on behalf of its foreign related party (the principal). These additional expenditures are challenged by tax authorities, which argue that these kind of expenses are not consistent with a limited risk distributor model and such additional "functions" must be compensated with an additional return in order to comply with the arm's-length principle.

Flagship Store Tax Issues[47]. As Mexico's upper middle class has grown, Avenida Presidente Masaryk, the main street in the capital city's fashionable Polanco area, has transformed into Mexico's version of Rodeo Drive (LA), with boutiques including Louis Vuitton, Burberry, Cartier and Bulgari.

In the past two years, Mexico City's luxury shopping has run into problems, because rents have fallen and consumers have decreased spending on these items, due to a period of economic uncertainty and tax reforms. Despite this recent weakness, Avenida Presidente Masaryk is considered the standard for shopping in Mexico City, and Polanco has attracted a few recent, high-profile leasing deals. In the past year, Dolce & Gabbana opened a 350-square-meter store at 450 Masaryk, menswear company Harmont & Blaine took 185 square meters at 433 Masaryk, and Colombian women's brand Studio F leased 500 square meters in a space at the corner of Masaryk and Aristoteles Street. Each lease was between $85 and $100 US per square meter, near the top end of the price range for the area.

There has not been to date any case or issue relating to flagships stores in Mexico, because Mexican Income Tax Law does not limit the deductibility of the expenses relating to the placement of these stores. In most cases, the main expense associated with flagship stores is the excessive rental cost for being located in a "luxury area" (such as Masaryk). Because the perception is that the only reason to have a store in Mexico is to position the brand and be recognized, at times these stores generate minimum revenues compared to other stores of the same brand around the world. In a transfer pricing context, it is important to note that, depending on the

[47] *The Wall Street Journal* article, October 2013.

operating model used, the aforementioned expenses can be absorbed either by the Mexican resident or by the foreign related party.

Period of NOLs. In Mexico, tax authorities generally accept operating losses for a period of three years. However, it is important that the taxpayer prepare and keep documentation evidencing their financial condition.

Financing/Reclassification. There is no specific finance rule for the luxury and fashion industry in Mexico. However, each group should take into account thin capitalization rules, established in article 28, section XXVII of the MITL, providing that the interest paid to related parties will not be deductible in amounts exceeding the 3:1 ratio of liabilities to equity of the company. The rule does not apply to entities that are part of the Financial System (as defined in the MITL). Other exemptions and waivers regarding thin capitalization rules may apply: e.g., taxpayers that obtain an APA for intercompany loan transactions are not subject to this limitation.

Value-added Tax. In Mexico, the following activities are subject to the VAT:

- transfer of goods;
- independent services;
- use or temporal enjoyment of property; and
- import of goods and services

For intangible assets, the sale or transfer of goods is considered to be made in national territory when the purchaser and the seller are residents in Mexico. Therefore, the amount to be paid would be a rate of 16 percent on the price or amount of the transaction, as well as other charges made to the purchaser for other taxes, rights, interest, or any other concept. Valuing the transfer of an intangible on its own is at times more difficult than combing the IP with transfer of a tangible good. This means that if the value of the intangible is embedded in the sale or transfer of tangible goods, the taxable value will be the total amount of the good.

Pursuant to article 5-D, imported goods are subject to this tax:

> *"The payment for import of tangible goods will be made as provided in Article 28 of this Law. For purposes of this law, tangible goods are those that can be touched, weighed or measured; and intangible assets are those that do not have at least one of these characteristics"*

For the purposes of calculating the taxable value of imported goods, the percentage paid must be 16 percent of the value, as well as additional charges, including royalties and license rights, only if these are not included in the amount paid.

In both cases, when the payment of royalties is favorable to a foreign resident, this payment would be subject only to a withholding tax of 25 percent but only for income tax not for VAT.

2. Tax Controversies

Mexican taxpayers have three main transfer pricing obligations:

- to carry out transactions with related parties and unrelated parties residing in low- or no-tax jurisdictions (tax havens), under the arm's-length principle;
- to file an annual information return regarding transactions with foreign related parties; and
- to prepare a transfer pricing study yearly.

Article 76, section IX of the MITL indicates that taxpayers carrying out transactions with non-resident related parties must prepare and maintain documentation establishing that their taxable income and deductions have been agreed at arm's length. This transfer pricing documentation must be prepared each year, no later than the filing date of the Statutory Tax Audit Report (i.e., June).

Unless proven otherwise, article 179 of the MITL assumes that any transaction conducted with companies residing in low tax regimes (as defined in the MITL), will be deemed a transaction between related companies at non-arm's length values. The MITL further provides that payments made to tax haven residents are not deductible, unless the taxpayer proves that the price or consideration is at arm's length.

Article 76, section XII establishes that companies conducting related-party transactions, whether they are foreign or domestic, must comply with the arm's-length principle. Consequently, evidence of the domestic transactions' compliance with the arm's-length standard must be proven through the application of one of the transfer pricing methods established in the regulations.

The transfer pricing documentation that must be prepared each year must consist of the following information:

- name of the related company residing abroad;
- information relating to the assets, functions and risks per type of transaction (functional analysis);
- specification of each transaction carried out with related parties, including type of transaction, amount and name of related party;
- method applied pursuant to Article 180 of the MITL, as well as the specification of the comparable companies used in the assessment of each type of transaction; and
- exhaustive proof of the best method rule procedure used in each transaction.

Article 76, Section IX of the MITL provides that for the year immediately preceding the current fiscal year, taxpayers who earn an income of less than MXP13 million (approximately US$1 million) from business activities, or MXP3 million (approximately US$0.23 million) from the performance of services are not obligated to prepare and maintain the transfer pricing documentation described in the MITL. These thresholds do not exempt taxpayers from the obligation of presenting the transfer pricing information return.

Alternative Dispute Resolution.

Mexican taxpayer can request a unilateral APA for intercompany transactions to which the transfer pricing legislation applies. They can also request bilateral and multilateral APAs if the transactions are with related entities in countries in which Mexico has a double taxation agreement.

International/Regional Concerns

The principal concern in Mexico, as well as in other countries included in this handbook, is the transfer and valuation of the intangibles. Specifically in the luxury and fashion industry, intangibles are essential in the transfer pricing evaluation, largely due to their volatility and the level of the marketplace. Since most of the higher-end retail stores in Mexico do not own their brands or trademarks, nor are they registered in Mexico, the Mexican entities typically either pay royalties to their related party or the brand owner, or that value of the brand is embedded in the transfer price of the goods.

According to article 32 of the MITL, deferred charges are intangible assets represented by property or rights to reduce operating costs, improve the quality or acceptance of a product, or use, enjoy or exploit a good, for a limited period, which less than the term of the company activity. Deferred expenses are also considered intangible assets for the exploitation of public property or the provision of a public service. Under article 33 of the MITL, the expense would be deducted on a 15 percent basis specifically for royalties, technical assistance, and other deferred expenses. In the MITL, the concept of royalties is explained in article 15-B of the Fiscal Federal Code (FFC), where the payment for this concept, made to a domestic related party, must be considered as a cumulative income and the corresponding income tax must be paid. If the payment is made to a foreign related party without permanent establishment in Mexico, article 167 of the MITL establishes the following:

> *In case of royalty income for technical assistance or advertising, the source of income is considered in national territory when the property or rights for which royalties or technical assistance are paid and used in Mexico, or when royalties, technical assistance or advertising is paid by a national resident or by a foreign resident with permanent establishment in the country.*
>
> *The tax will be calculated by applying to the income obtained for the taxpayer without any deduction the following rates:*
>
> *I. Royalties for the use of temporary enjoyment of railroads cars ---------5%*
>
> *II. Other royalties than those covered in section I as well as technical assistance----25%*

The above means that when the payment of royalties is favorable to a foreign resident, this payment must be subject to a withholding tax of 25 percent without any deduction, given that Mexican regulations consider the foreign resident obtained income from a source located in Mexico for which it must pay the corresponding tax. Nevertheless, Mexico has executed a large number of treaties to avoid double taxation with several countries, which generally provide benefits, such as reduced withholding, to taxpayers.

For transfer pricing purposes, the OECD, in its July 2013 “Transfer Pricing Aspects of Intangibles” established that the analysis of cases involving the use or transfer of intangibles should begin with a comparability analysis, including a functional analysis. The functional analysis should identify the functions performed, assets used, and risks assumed by each relevant member of the multinational group. To determine arm’s-length conditions for the use or transfer of intangibles, the OECD states that it is important to consider the following items as part of the comparability and functional analysis:

- The identification of specific intangibles. In the identification of specific intangibles, the word “intangible” is intended to address something that is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances; not necessarily recognized as an intangible asset for accounting purposes or legally protected.
- The legal ownership of intangibles and the contributions to their development, enhancement, maintenance and protection. The legal owner of an intangible may initially

be entitled to receive the proceeds from exploitation or transfer of the intangible; other members of the owner's multinational group may have performed functions, used or contributed assets, or assumed risks that are anticipated to contribute to the value of the intangible and for which they must be compensated under the arm's-length principle. The terms of a transaction may be found in written contracts, or public records such as patent or trademark registrations. If no legal owner of the intangible is identified under the applicable law or governing contracts, then the member of the multinational group that, based on the facts and circumstances, controls decisions concerning the use and transfer of the intangible, and has the practical capacity to restrict others from using the intangible, will be considered the legal owner.

- The nature of the controlled transactions involving intangibles, including the manner in which such transactions contribute to the creation of value. In considering the prices to be paid for functional contributions and the allocation of returns attributable to intangibles among members of the multinational group, certain functions will have special significance. Depending on the facts and circumstances, these more important functions would generally include design and control of research and marketing programmes, management and control of budgets, control over strategic decisions regarding intangible development programmes, important decisions regarding defense and protection of intangibles, and ongoing quality control over functions performed by independent or associated enterprises that may have a material effect on the value of the intangible.

Brazil

Although the Brazilian luxury and fashion industry has developed in the last decades, the high tax burden over imports of goods into Brazil, which usually is the structure adopted by such businesses, represents an obstacle to the growth of this industry in Brazil.

The tax system in Brazil is decentralized in three different levels (federal, state and municipal levels). This results in a complex set of rules and potential increase of tax costs, which restrains the development of local industries.

Specifically regarding the luxury and fashion industry, it is important to note that certain Brazilian taxes follow the constitutional principle of selectivity (*princípio da seletividade*). This means that the rates of such taxes are inversely proportional to the essentiality of the product.

1. Transfer Pricing and Other Issues

Overview of Rules. The Brazilian transfer pricing rules provide four methods to determine maximum deductible expenses, costs and charges related to goods, services or rights imported from a related party: (i) the Comparable Uncontrolled Price ("PIC"); (ii) the Resale Price Less Profit ("PRL"); (iii) Production Cost Plus Profit (CPL); and (iv) the Exchange Import Price (PCI) that specifically applies to the importation of commodities. For the amounts remitted abroad to be fully deductible, without transfer pricing adjustments, the taxpayer must prove that the corresponding costs, expenses and charges do not exceed at least the amount calculated according to one of the four methods set forth by transfer pricing regulations for imports (the so-called "parameter price"). The method may be chosen by the taxpayer according to its convenience (there is no best method rule in Brazil, except for commodities). The luxury and fashion industry may adopt the Resale Price Less Profit Method (RPM), to the extent that it may be utilized when the imported goods, rights or services are resold, either exactly as imported or after being submitted to a industrial process in Brazil. The statutory profit margin applicable to the RPM may be 20, 30 or 40 percent depending on the specific business sector of the taxpayer subject to transfer pricing control. The catch-all profit margin is 20 percent, which shall be applied to the luxury and fashion industry with few exceptions, such as pharmaceutical products that are subject to the 40 percent profit margin. In view of that, if the Brazilian importer resells the goods imported from a related party with a high markup, it is possible that no transfer pricing adjustment will apply.

For customs valuation, Brazilian law follows the General Agreement on Tariffs and Trade (GATT) of the World Trade Organization (WTO), specifically the Agreement for Implementation of Article VII, which provides that customs valuation will generally be determined by the effective value of the transaction.

Difficulty of establishing comparables. Brazilian transfer pricing rules do not provide for a best method rule. The taxpayer may always use the RPM to comply with the rules, without the need to establish comparables. On the other hand, from a customs valuation standpoint, luxury and fashion products may have an issue in obtaining comparables. All importers of record must register the import transactions in the so-called SISCOMEX (a computer network of the Federal Revenue Department, the Foreign Trade Department and the Central Bank of Brazil). Therefore, all prices declared in the Import Declaration are automatically included in SISCOMEX and compared with the prices already existing in the database. These prices are included according to the tariff classification of the goods, regardless of their own specific characteristics (e.g., quality, luxury brand). Usually, the focus of the customs authorities is on inspecting imported goods whose customs value is lower than the average registered in the SISCOMEX database. For this reason, if the declared price is higher than the price included in the database, resulting in a higher levy of taxes, the customs valuation should not be a significant issue, provided that the same goods are not imported by any other party for a higher amount. Otherwise, in this case, the customs authorities would have a high comparable price.

Marketing Intangibles Issue for Brands. The tax treatment applicable to intangibles may be peculiar to Brazil. Brazil imposes a limit for the tax deduction of payments for patents, know-how and technical assistance of up to 5 percent, calculated upon net sales of the products manufactured or the services rendered under the agreement. In the case of related companies, the same percentage applies as a limit for remittance of royalties to the parent company abroad.

Flagship Store Tax Issues. While the prime function of the flagship store is to generate brand value rather than profit, it may draw the tax authorities' attention if the store operates in a loss position for a long period of time. Another issue is the possibility of accumulated tax credits (e.g., Federal Excise Tax (IPI), State Value-added Tax (ICMS and PIS/COFINS)), which might not be refundable. The Brazilian importer may offset taxes collected upon imports against the amount of the same taxes on the subsequent transaction performed with the imported goods. If the flagship store operates with a negative markup, the tax basis for the internal outflow transaction with the imported good would be lower than the tax basis for the taxes due on the import (i.e., the customs value). In this case, the Brazilian importer might accumulate tax credits, which is not only inefficient but could also attract the tax authorities' attention. Finally, if the flagship store is subject to transfer pricing control in Brazil and does not apply a significant markup upon the local sale, the flagship store may have difficulties in complying with Brazilian transfer pricing rules.

Period of NOLs. NOLs do not expire in Brazil. However, they cannot be monetarily corrected to inflation. In addition, there is a rule of limitation under which NOLs can only offset up to 30 percent of the taxable income of any given tax year. There is also a “basket” limitation, which provides that losses generated by non-operational transactions can only be used to offset non-operating gains. Non-operating results are generally considered to be those deriving from the disposal of permanent assets. The NOLs’ utilization upon a merger, amalgamation and a split of companies in Brazil is also subject to limitations. Finally, an entity loses the right to use NOLs if between the date the NOLs were generated and the date of utilization, there are, cumulatively, a change of corporate control (*controle societário*) and a change of the company’s line of business (*ramo de atividade*).

Financing/Reclassification. There is no specific finance rule for the luxury and fashion industry, but there are certain anti-avoidance rules that should be taken into account. One example refers to the thin capitalization rules, which restrict the deductible interest expense for a Brazilian resident company on a loan from a related entity domiciled outside Brazil or an entity located in a low tax jurisdiction or subject to a privileged tax regime. As a general rule, the sum of the debt funding, verified on the date of the accrual of the interest, shall not exceed two times the amount of equity participation of the related foreign party in the net equity of the Brazilian company. For transactions with parties subject to privileged tax regimes or domiciled in low tax jurisdictions, the limit of deductibility is 30 percent of the net equity of the Brazilian party, regardless of any effective equity participation held by the foreign party in the Brazilian entity.

2. Tax Controversies

The main points to be aware of from a Brazilian perspective are the lack of comparables for customs valuation purposes, as well as the specific rules applicable for each tax in all three different levels of taxation (federal, state and municipal).

Specific Taxation Rules. From a VAT tax perspective, luxury and fashion products are subject to the normal taxation applicable to the supply of goods. However, based on the principle of selectivity, luxury and fashion products, due to their lower level of essentiality, are usually subject to a higher tax burden in Brazil. This is mainly reflected by the Federal Excise Tax (IPI), a non-cumulative tax due upon imports of industrialized goods and also upon the outflow of industrialized goods from the manufacturer’s or importer’s establishment. The IPI has tax rates inversely proportional to the essentiality of the product.

According to Law No. 10,147/00, the importer or manufacturer of cosmetic products must collect PIS/COFINS (Social Contributions) under the single phase taxpayer model at a higher tax rate of 12.5 percent and with no right to tax credits. PIS/COFINS is usually levied over all phases of the commercial chain at a 9.25 percent rate over the gross revenues of Brazilian taxpayers, with a right to tax credits under the non-cumulative regime. There is another Social Contribution named PIS/COFINS-Import, which is due upon imports of goods into Brazil. PIS/COFINS-Import general rate is 9.25 percent as well. However, the increased tax rate of 12.5 percent for cosmetics also applies to PIS/COFINS-Import. PIS/COFINS-Import paid by the importer may offset the

PIS/COFINS locally levied over the gross revenues obtained on the subsequent sale transaction, even in the so-called single phase taxpayer model, which applies to cosmetics products.

For the State Value-added Tax (ICMS), which is also a non-cumulative tax levied upon the circulation of merchandise, there is the so-called tax substitution regime that may apply to certain luxury and fashion products, such as cosmetics. Under the tax substitution regime, the first player of the commercial chain (importer/manufacturer) is required to collect the total amount of ICMS that should be levied upon all transactions, from the importer/manufacturer until the end customer. The ICMS rates vary depending on the tariff classification of goods, on the nature of the transaction (internal or interstate transaction) and also on the state where the goods circulate. Upon internal transactions, the general rates are 17, 18 or 19 percent, depending on the specific state. For interstate transactions, the rate usually is 12 or 7 percent, depending on the state to which the goods are shipped. The interstate rate for imported goods or goods with imported content higher than 40 percent is 4 percent, though.

Due to the complex set of VAT tax rules, there is usually room for tax planning concerning to where and how to structure the supply chain in Brazil.

Finally, certain luxury products, such as wristwatches and pocket watches, are required to obtain a special control seal (*selo de controle*) in order to be commercialized in Brazilian territory.

3. Alternative Dispute Resolutions

There are no arbitration clauses in Brazilian tax treaties. In addition, there is no possibility of commencing an arbitration procedure with the tax authorities.

The government agency in charge of overseeing and applying the transfer pricing rules is the Federal Revenue Department, which is a part of the Ministry of Finance.

There are no domestic regulations for APAs. There is currently no procedure under which a taxpayer may enter into a unilateral, bilateral or multilateral APA with the tax authorities. It is possible to apply to the Ministry of Finance for a change in the statutory margins provided for the purposes of the PRL and CPL transfer pricing methods, in accordance with Ordinance 222/09.

4. International/Regional Concerns

Although Brazil has not signed the OECD Convention, it has adopted the OECD Model relating to Treaties to Avoid Double Taxation. Currently, 30 Treaties to Avoid Double Taxation are in force in Brazil.

Canada

The biggest names in the luxury and fashion industry operate flagship stores in Toronto and other major Canadian cities, as well as other stores in many other retail centers. The Canada Revenue Agency (CRA) has traditionally subjected multinationals to close scrutiny from a transfer pricing perspective, and the luxury and fashion industry is no exception. While many of the issues raised by other tax authorities are raised by the CRA (such as royalties for marketing intangibles versus locally incurred AMP costs, full fledged versus limited risk distribution models, and foreign exchange rate risk issues), the CRA also considers whether the Canadian operations should realize higher returns than other group entities, given the perception that the Canadian economy was not impacted as much by the fallout from the financial crisis. This was because, among other things, housing prices did not decline materially in Canada, and the financial sector was viewed as one of the strongest and best regulated in the world, so the massive bailouts to prevent major financial institutions from collapsing were avoided.

1. Transfer Pricing and Other Issues

Overview of Rules. Canadian resident corporations, as well as non-resident corporations carrying on business in Canada, are required to comply with Canada's transfer pricing legislation as set out in the Income Tax Act (ITA). Generally, the CRA, which administers the ITA, follows the 2010 OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. The CRA has issued a variety of guidance documents, including Information Circulars, Interpretation Bulletins and Transfer Pricing Memoranda, that set out its views on a variety of topics related to transfer pricing.

Taxpayers must be able to demonstrate that their transactions with related parties are conducted on terms and conditions that would have prevailed if they were dealing at arm's length. The CRA has the authority to adjust prices or other terms and conditions of transactions to the extent they are not consistent with what arm's-length parties would have agreed to. Moreover, the CRA has the authority to recharacterize a transaction if it is one that arm's-length parties would not have entered into and it was only entered into by the taxpayer to obtain a tax benefit.

Should the CRA make an adjustment to a taxpayer's transfer prices, it may also impose a transfer pricing penalty of 10 percent of the adjustment if the adjustment exceeds the lesser of CAD$5 million or 10 percent of revenue. This penalty will apply regardless of whether there is a tax deficiency (e.g., even if there are loss carry forwards that result in no additional taxes owing).

Penalties do not apply if the taxpayer has made reasonable efforts to determine and use arm's-length transfer prices. Canadian legislation notes that contemporaneous documentation that is "complete and accurate in all material respects" is necessary (but not necessarily sufficient) to avoid penalties. This documentation requires the disclosure of relatively detailed descriptive information about the taxpayer's business operations, financial results, and other relevant information. In addition, economic analysis supporting the arm's-length nature of the terms and conditions of the intercompany transactions is essential. Specifically, subsection 247(4) of the ITA sets out the reasonable efforts exemption to transfer pricing penalties as follows:

> …, a taxpayer or a partnership is deemed not to have made reasonable efforts to determine and use arm's length transfer prices …, unless the taxpayer or the partnership, as the case may be, makes or obtains, on or before the taxpayer's or partnership's documentation-due date for the taxation year or fiscal period, as the case may be, in which the transaction is entered into, records or documents that provide a description that is complete and accurate in all material respects of
>
> - the property or services to which the transaction relates,
> - the terms and conditions of the transaction and their relationship, if any, to the terms and conditions of each other transaction entered into between the participants in the transaction,
> - the identity of the participants in the transaction and their relationship to each other at the time the transaction was entered into,

- the functions performed, the property used or contributed and the risks assumed, in respect of the transaction, by the participants in the transaction,
- the data and methods considered and the analysis performed to determine the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the transaction, and
- the assumptions, strategies and policies, if any, that influenced the determination of the transfer prices or the allocations of profits or losses or contributions to costs, as the case may be, in respect of the transaction.

If the CRA proposes adjustments that exceed the penalty threshold or proposes to recharacterize a transaction, the auditor is required to refer the matter to the CRA's Transfer Pricing Review Committee (TPRC) for consideration. The objective is to ensure consistency in the application of penalties and recharacterization across the country. The TPRC will review the file, the CRA auditor's recommendations, and the taxpayer's written submission, and make a determination as to the applicability of penalties or the proposed recharacterization. If the taxpayer has not prepared contemporaneous documentation, then it is deemed not to have made reasonable efforts and penalties will apply. Proper contemporaneous documentation is therefore an important aspect of a taxpayer's compliance efforts in Canada.

To aid the CRA in its enforcement activities related to transfer pricing, taxpayers are required to file form T106. Form T106 must be filed if the taxpayer enters into with related parties transactions with an aggregate value of CAD$1 million or more during the taxation year. The information reported includes, inter alia, the identity(ies) of the counterparty(ies), the nature and quantum of the transactions, the transfer pricing method applied, and the existence of contemporaneous documentation. These forms are to be filed by the tax filing deadline for the taxpayer with the Ottawa Technology Centre, Validation and Verification Division, Other Programs Unit (they are not filed with the tax return). There are also late filing, failure to file, and false statement or omission penalties that may apply with respect to form T106.

<u>Difficulty of establishing comparables</u>. While Canada does have local stock markets that allow for searches for publicly traded Canadian companies as potential comparables, it is often difficult to identify Canadian company comparables. Many Canadian entities in the retail industry that might otherwise be available as potential comparables are fully fledged entities with their own well-developed brands, integrated supply chains to a greater or lesser extent, and/or are involved in design and development, and/or other activities, or bear risks that often do not match the profile of the Canadian tested party closely enough to be considered comparable. Additionally, Canadian securities regulators do not, as the SEC does, require the disclosure of material contracts, which severely limits the availability of local market licensing transactions covering marketing transactions.

To overcome these limitations, many companies rely on U.S. comparables, whether companies or agreements. This approach has its benefits, primarily in having a much larger universe of potential comparables from which to choose. However, the approach also has its drawbacks. Many U.S.-based comparables purchase in their own currency, the U.S. dollar, while many Canadian entities (whether the tested party or Canadian comparables) purchase in a foreign currency, the US dollar, thereby exposing them to foreign exchange risk. This foreign exchange risk has had a material impact on profitability over a number of years as the Canadian dollar has appreciated materially against the U.S. dollar (and has begun to depreciate somewhat recently). Also, as referenced above, widespread media coverage and economic commentary suggests that the Canadian economy did not suffer the same negative impact that the U.S. economy did following the 2008 financial crisis, calling into question the reliability of U.S. comparables for evaluating a Canadian tested party.

While there are challenges in developing a supportable benchmarking analysis, particularly when relying on non-Canadian comparables, reasonable and supportable positions can be developed if taxpayers carefully consider, analyze and document the various comparability issues and their potential impacts on the benchmarking analysis.

Marketing Intangibles Issue for Brands. In addition to the challenges associated with identifying suitable comparables, the CRA tends to closely scrutinize local AMP costs, and often argues that the local entity's spending on such costs has given rise to a locally owned marketing intangible that warrants greater compensation or higher expected returns for the Canadian entity. The CRA also commonly analyses the costs for any AMP costs that are non-deductible under the ITA (e.g., costs for advertising in a U.S. publication with Canadian exposure may be non-deductible, while costs spent on advertising in the Canadian edition of the same publication may be deductible), so care must be exercised, particularly if the Canadian entity is responsible for bearing a share of costs incurred by related parties.

Flagship Store Tax Issues. As with other jurisdictions, the key issues associated with flagship stores revolve around relatively high costs, profitability, the connection with brand and marketing intangible development, and the entities that should be responsible for these. Canada also has a unique geography, with a large territory to cover, and a relatively low population density compared with many metropolitan areas in the U.S. and major European and Asian centers.

Period of NOLs. A period of operating losses may be acceptable under appropriate circumstances. For example, if the Canadian subsidiary incurred start-up costs or market penetration costs as a full fledged, entrepreneurial entity that was also responsible for developing the local market, it may be expected to bear certain losses. However, it would be expected that the entity would realize higher levels of profit in the future as a result of its investment. On the other hand, a LRD would not normally be expected to bear such costs and, as a result, such losses are likely to be challenged by the CRA.

Operating losses are generally available to be carried forward for 20 years or carried back three years.

Intercompany Financing. Intercompany financing transactions tend to attract a lot of scrutiny from the CRA, which continues to seek cases suitable for litigation. While the arm's-length principle applies to intercompany financing transactions, the CRA tends to view the Canadian entity as an important element of the global group, which therefore benefits from implicit support. This implicit support narrows the gap between the parent company credit worthiness and that of the subsidiary in question. There are also other relevant rules, such as the recently implemented ones prohibiting foreign affiliate dumping, thin capitalization rules (i.e., 1.5 to 1), and rules that make cash pooling ineffective in Canada, to name a few. Care must be taken when planning financing transactions with a Canadian subsidiary to ensure compliance with varied rules while still achieving the company's business and tax objectives.

Value-added Tax. Canada imposes a VAT known as the Goods & Services Tax/Harmonized Sales Tax (GST/HST) on the supply of most property and services in Canada. GST applies at a rate of 5 percent in all Canadian provinces and territories, with the exception of Ontario, Newfoundland, New Brunswick, Nova Scotia and Prince Edward Island (PEI). These five provinces have harmonized their provincial retail sales tax (PST) systems with the federal GST and, accordingly, HST applies at a rate of 13 percent on supplies made in Ontario, New Brunswick and Newfoundland; 14 percent on supplies made in PEI; and 15 percent on supplies made in Nova Scotia. In addition, Quebec has a provincial VAT called the Quebec Sales Tax (QST) that operates in a similar manner to the GST/HST and applies at a rate of 9.975 percent. Luxury goods are generally subject to GST/HST and QST. Businesses in general are able to recover GST/HST and QST paid on purchases of property and services acquired for consumption, use or supply in the course of their taxable activities.

The provinces of Saskatchewan (5 percent), Manitoba (8 percent) and British Columbia (BC) (7 percent) impose PST that generally applies to tangible personal property and certain services. Luxury goods are generally subject to PST. Businesses are typically unable to recover PST paid. However, businesses may generally purchase goods on a PST-exempt basis if the goods are acquired for resale.

2. Tax Controversies

The CRA has a relatively high proportion of international examiners, and auditors are required to ask for a taxpayer's contemporaneous transfer pricing documentation at the outset of any audit. As a result, companies should expect to have their transfer pricing audited. Transfer pricing disputes can be resolved in a number of ways. These include attempting to resolve the issue with the field auditor, who may or may not be supported by transfer pricing specialists and/or economists from the CRA's head office in Ottawa, pursuing the normal appeals process including potential litigation, requesting competent authority assistance under one of Canada's many bilateral income tax conventions with other countries, and/or through the advanced pricing agreement procedure.

MAP: Canada has one of the most extensive treaty networks in the world and a well-functioning MAP process to aid taxpayers in resolving double taxation issues. Canada agreed to include a mandatory arbitration clause in the latest treaty protocol with the U.S. that is credited with expediting the resolution of double tax cases with the U.S. (Canada's largest trading partner). It has also has spillover effects on dealing with other countries as Canada improves its efficiency in negotiating and resolving cases. Canada and the U.K. have also announced the inclusion of an arbitration provision in the latest protocol to their treaty. The details on the functioning of the process are still to be worked out. Full details about Canada's MAP program are available in Information Circular 71-17R5 *Guidance on Competent Authority Assistance Under Canada's Tax Conventions*.

APAs: Canada has a robust APA program and will consider bilateral or unilateral APAs. The CRA has implemented multiple changes to the process over the last several years as the arbitration provision in the Canada–U.S. Tax Convention became effective. The key steps in the process from a Canadian perspective are:

Pre-filing process

This phase requires the preparation of a package of information that presents a detailed summary of the key facts, transactions to be covered, and the proposed approach to address the transactions. This phase also involves meetings with both the CRA and the foreign tax authority to review the pre-filing materials and discuss the case's suitability for the APA program.

The package must be submitted to the CRA for review before the CRA will commit to a pre-filing meeting, and the CRA may request additional materials be prepared or information submitted in advance of the pre-filing meeting.

Pre-submission due diligence

Once the pre-filing meetings are concluded, it is possible that the CRA will wish to conduct further due diligence prior to inviting the taxpayer to submit a formal request for an APA. This will likely take the form of responding to specific written queries from the CRA. In some cases, the CRA may elect instead to specify certain additional issues or analyses that it will require the taxpayer to include in its APA request.

APA submission/request

The CRA process differs somewhat from that of other tax authorities. After the pre-filing meeting, the taxpayer can typically submit an APA request to other tax authorities without further steps. The CRA will invite the taxpayer to submit a formal APA request once it has completed its pre-submission due diligence.

The formal APA request includes a detailed transfer pricing study along with specified additional attachments, declarations and related materials. These are set out in CRA Information Circular 94-4R. Any additional requirements imposed by the CRA during the pre-filing process must also be included.

Due diligence/site visits

Once the CRA has had the opportunity to review the APA requests/submission, it will conduct its own due diligence. The CRA typically requires site visits.

Queries and responses

Once the site visits are completed, the CRA will issue one or more rounds of queries.

Draft position paper

The CRA will prepare a draft position paper and share it with the taxpayer, and the taxpayer will have the opportunity to review and provide feedback on the draft position.

Negotiations

The tax authorities will exchange position papers, meet one or more times to negotiate, and then reach an agreement on the treatment of the transactions, subject to the APA request.

APA agreement

Once the negotiations are complete, the tax authorities will both provide draft APA agreements to the respective taxpayers for review and agreement. The taxpayer will have to review the agreements to ensure consistency and, subject to any required revisions, sign and return the agreements to the respective tax authorities.

Annual compliance

Once the APA has been completed, the taxpayer will have to demonstrate compliance with the terms of the APA. For years where tax returns have been filed prior to the completion of the APA, amended returns may have to be filed to implement the terms of the APA. For all years covered by the APA, the taxpayer will have to prepare and submit an annual report to the CRA, demonstrating compliance with the APA. This report makes representations as agreed in the APA with the CRA and will set out the necessary calculations. This will be briefer than traditional transfer pricing documentation. Future transfer pricing audits will be limited to evaluating compliance with the terms of the APA.

Colombia

Purchasing power of Colombians has increased, and with it the interest of luxury brands and renowned designers in franchising or opening stores in Bogotá and other main cities. During the last two years, a significant number of luxury and fashion firms have entered the Colombian market, following the economic turnaround of the country.

The luxury and fashion industry is gaining new strength in Colombia, and it has high potential. A stronger, larger, richer middle class, a more optimistic population, a safer investment environment and a stable economy are a good mix for its expansion.

1. Overview of the Transfer Pricing Rules

Transfer pricing regulations were adopted by Colombia in 2004, following the OECD guidelines. The most recent changes to the transfer pricing regime in Colombia took place at the end of 2012, by means of a tax reform effective as from FY 2013. This reform modified several transfer pricing regulations provided in articles 260-1 to 260-11, including the arm's-length principle, related party criteria, comparability criteria, methodology and formal duties. Also, Regulatory Decree 3030 was issued on December 2013. This decree relates to the transfer pricing rules and substitutes the previous one (Decree 4349).

Article 260-2 of the Tax Code sets forth that taxpayers carrying out transactions with related parties abroad or in tax havens are required to determine their ordinary and non-ordinary income, costs and deductions, assets and liabilities, considering for those transactions the prices and amounts that would be used with or between independent parties in comparable transactions.

This obligations also apply for (i) permanent establishments; (ii) domestic taxpayers regarding the transactions performed with local related parties located in a Free Trade Zone; and (iii) taxpayers having transactions with domestic related parties with regards to the foreign permanent establishment of one of them.

As a general rule, taxpayers that perform transactions subject to transfer pricing rules have to file informative returns, and to prepare contemporaneous documentation proving that the transactions carried out with related parties residing abroad or with companies residing in tax havens are pursuant to the arm's-length principle. Starting FY 2013, all taxpayers obligated to prepare contemporaneous documentation have to file it before the tax administration, while prior to 2013, it had to be filed only upon request.

Taxpayers that do not meet the aforementioned thresholds are not obligated to comply with formal requirements (informative return and documentation).

Taxpayers are exempted from the requirement to prepare transfer pricing documentation if, either (i) the taxpayer has transactions with tax havens, and the amount of such transactions is less than 10,000 UVT; or (ii) the taxpayer has no transactions with tax havens and that the amount of intercompany transactions is less than 61,000 UVT.

Intercompany transactions of less than 32,000 UVT are exempted from the transfer pricing documentation; however, they must still be included in the informative return.

Economic Bonding Criteria/Related Parties

For Colombian purposes, a related party condition arises when a taxpayer meets one of the following criteria:

<u>*Subordinated Enterprises*</u>

An enterprise shall be deemed subordinated or controlled when its decision-making power is subject to the will of other person(s) that is its parent or controlling company, either directly, in which case it will be called an affiliate, or with the participation or through the subordinates of the parent company, in which case it will be called a subsidiary.

An enterprise will be subordinated when one or more of the following cases applies:

- When more than 50 percent of the capital is owned by the parent company, either directly, or through or with the participation of its subordinates or the subordinates of the parent company. For such purpose, shares with preferential dividends and with no right to vote shall not be counted.
- When the parent company and the subordinates have, either jointly or separately, the right to issue votes constituting the minimum decisive majority in the stockholders' meeting or in the assembly, or have the number of votes necessary to elect the majority of the members of the Board of Directors, if any.
- When the parent company, either directly or with the participation of subordinates, in connection with an act or business with the controlled company or with its partners, exercises dominant influence in the decisions of the administrative bodies of the company.
- When the control, according to the assumptions foreseen in this chapter, is exercised by one or several individuals or corporate bodies that are not partnerships, either directly or with the participation of entities where they own more than 50 percent of the capital, or configures the minimum majority to make decisions or exercise dominant influence in the direction or decision-making of the entity.

- When a person or entity has the right to receive 50 percent of the profits of the subordinated entity:
  - Branches, regarding their Main Office
  - Agencies
  - Permanent Establishments
  - Others
- When the transaction subject to tax takes place between two subordinates of the same parent company.
- When the transaction takes place between two subordinates where their capital is owned directly or indirectly by the same individual, entity or corporate body domiciled or not domiciled in the country.
- When the transaction takes place between two enterprises, of which one person or entity participates directly or indirectly in the administration, control or capital of both of them. (i.e., having more than 50 percent of the capital, or the capacity to control the business decisions of the company).
- When the transaction takes place between two companies where 50 percent or more of their capital is owned by persons related to each other by marriage or by kinship up to the second degree of consanguinity or affinity, or sole civil degree.
- In transactions between economic associates through third parties that are not related.
- When more than 50 percent of gross revenues come from individual or joint partners or shareholders, community members, partners, subscribers or similar.
- Where there are consortia, joint ventures, participation accounts, and other forms of association that do not give rise to legal persons.

Arm's-Length Pricing

The main requirement for taxpayers in Colombia is to carry out transactions with related parties residing abroad and with taxpayers, based on the arm's-length principle (Tax Code, Article 260-2 and 260-7). This is also applicable to domestic taxpayers having transactions with local related parties located in a Free Trade Zone.

Comparability Criteria

Colombian law specifies, in article 260-4 of the Tax Code, the use of the five basic factors of comparability:

- Characteristics of goods and services
- Functions carried out, assets used, and risks assumed in the transaction
- Contractual terms
- Economic or market circumstances
- Business strategies

Regarding the comparability element of "characteristic of goods and services", the reformed article 260-4 and Decree 3030 state that for the particular case of financing transactions, whenever interests paid do not comply the comparability elements stated in such article (principal, term, risk, guarantee, debtors solvency, interest rate), such interests will be treated as non-deductible and characterized as dividends, and the loan treated as capital.

Another important element included in the body of the law beginning in 2013, is that internal comparables have to be considered as a priority when assessing the arm's-length principle.

Transfer Pricing Methodology

Similar to other Latin American transfer pricing legislations that follow the OECD criteria, the following are acceptable methods under the tax bylaws:

- Comparable Uncontrolled Price
- Resale Price
- Cost Plus
- Transactional Net Margin
- Profit Split

As of 2013, article 260-3 states that for the particular case of purchase/sale of non-publicly traded shares or assets with difficulties in comparability, commonly accepted valuation methods have to be used to determine the arm's-length value (in particular, the discounted free cash flow), and under no circumstances would intrinsic value be accepted.

Best Method Rule

There is no legal priority in the application of transfer pricing methods in Colombia. Hence, there is no best method rule in the body of the law. However, Decree 3030 provides in article 4 that taxpayers must state in the transfer pricing documentation that the selected method is the most appropriate based on the characteristics of the transaction assessed, available information, comparability and reliability of adjustments.

Use of Statistical Tools

Article 260-3 of the Tax Code states that the application of any method may provide a range of prices or profit margins whenever there are two or more comparable transactions. This range (the total range), is deemed as the arm's-length range, and may be adjusted by statistical methods such as a percentile range or others whenever the taxpayer deems it appropriate in order to improve reliability of the analysis.

Here, Decree 3030 further states, in article 8, that taxpayers have to state in the transfer pricing documentation the technical reasons taken into account to select the arm's-length range or to adjust it with statistical tools.

Adjustments

Article 260-3 of the Tax Code establishes the possibility of applying reasonable adjustments to eliminate differences among the comparable transactions or companies. Decree 3030 states that technical, economic or accounting adjustments can be used and have to be properly described and documented in the transfer pricing documentation.

Selected and Secret Comparables

Tax authorities accepts foreign comparables data in case there is not enough information from local comparables, which is often the rule, due to the lack of public financial data of local companies.

Secret comparables are not yet an issue and the law does not provide any information about their utilization. However, it is understood that if confidential or secret information is used for comparability purposes, the local tax authorities may challenge this practice. Information must be from a public source.

Financial Information

Article 260-3 states that for purposes of applying the transfer pricing methods, revenues, costs, expenses, operating profit, assets and liabilities have to be determined according to generally accepted accounting principles in Colombia.

OECD Interpretation Sources

Transfer pricing law in Colombia does not expressly contain reference to the OECD Transfer Pricing Guidelines. Notwithstanding, provisions set forth in the law follow these guidelines and, in practice, taxpayers and tax authorities take them into account as a technical reference when preparing transfer pricing studies. Moreover, rulings from the Constitutional Court have accepted that OECD guidelines may be used as a source of interpretation of laws that are drafted based on its models. Finally, it is expected that an express reference to OECD guidelines be included in the law when Colombia completes its integration process to the OECD.

Intangible Issues for Brands

The Colombian tax authorities have started to review transactions that involve the use of intangibles. However, as of today there are no final decisions in any of the cases under audit.

Period of NOLs: Under current regulations, NOLs may be carried forward indefinitely.

Financing/Reclassification: No specific rules apply to the luxury and fashion industry. However, thin capitalization rules are applicable in Colombia, beginning in 2013. Pursuant to these rules, interest paid on debts that exceed three times the net equity of the taxpayer as of the end of the previous calendar year, is not deductible for income tax purposes. Note that this rule does not apply only to loans received from related parties, but to any interest bearing loan.

From a transfer pricing perspective, interest paid in excess of the arm's-length standard is disallowed and re-characterized as a dividend payment.

Value Added Tax: VAT is triggered upon the importation of goods into the country, and on the sale of goods and the rendering of services inside the country. Certain goods (raw food, vegetable products, some medicines, oil, gas, electricity, and similar items) and services (such as healthcare and transportation) are excluded from VAT. The general rate is 16 percent, but there are certain goods and services subject to different rates (i.e., 10 percent for cotton fiber, 20 percent for mobile telephone service).

As the tax is designed to cover the added value of goods and services in circulation, it is the end user who normally pays the cost of the tax. While those who sell goods and render services are legally accountable for VAT, they act as tax collectors and offset the VAT they pay with the VAT they collect from customers, and pay the excess of the latter over the former to the government.

2. Tax Controversies

In recent years the tax office has been very active in auditing transactions held by taxpayers with foreign related parties. Initially, the audits were aimed at reviewing whether taxpayers were complying with their formal obligations, but now they are more focused in reviewing and challenging the methodology used, adjustments made and comparables selected.

3. Alternative Dispute Resolution

A unilateral APA can be requested by any Colombian taxpayer involved in intercompany transactions to which the transfer pricing legislation applies. Very few APAs have been signed as of today.

C. Asian Pacific Region

Japan

The Japanese luxury and fashion market consistently maintains its position as one of the top three in the world in revenue terms, together with China and the United States. Virtually all luxury and fashion brands operate flagship stores throughout Japan, with high-end brands such as Burberry, Coach, Ferragamo and Gucci consistently deriving a generous and growing percentage of their global profits there.

Despite the recent slowing of retail markets in Japan, caused by the combined effects of changing demographics, a stagnant economy, increased price transparency, and more channel options such as travel retail and internet shopping taking a slice of the direct retail spend, it is still a vital and highly profitable market. Indeed, Japanese consumers remain some of the most discerning, loyal and important luxury customers in the world.

Among the primary business concerns for companies in the luxury and fashion industry in Japan are those involving transfer pricing. Transfer pricing audits in Japan are known for their intense scrutiny and aggressive adjustments. The Japanese luxury and fashion industry has seen an increasing number of transfer pricing audits in recent years, particularly on transactions pertaining to the importation of goods, services, marketing intangibles and royalties.

The focus of an audit will often depend on the business model adopted by the luxury and fashion brand, with the following models being the most common:

- licensing of the brand to the Japan retail operator, who pays a royalty and sources the products from affiliates;
- principal type structure, with the brand owner selling the product to local affiliates in return for a price reflecting the embedded value of the IP;
- the stand-alone model, with the local company bearing its own expenditure in the marketing and advertising of the brand; and
- joint venture.

Each business model attracts its share of transfer pricing audit scrutiny. The experience of those with long luxury and fashion industry histories in Japan shows that careful planning and clear division of responsibility backed up by robust documentation are the best preemptory defenses to many of the transfer pricing-related issues that may arise.

1. Transfer Pricing and Other Issues

Overview of rules: Japanese transfer pricing legislation is broadly consistent with the OECD transfer pricing guidelines. Article 66-4 of the Special Tax Measures Law (STML) provides for the following transfer pricing methods:

- The comparable uncontrolled price method (CUP)
- The resale price method
- The cost plus method
- The profit split method
- The transactional net margin method (TNMM).

For transactions other than the transfer of tangible inventory, transfer pricing methods "equivalent to" the methods used for tangible inventory are to be used (STML article 66-4 para 2(ii)). For fiscal years beginning on or after 1 October 2011, the so-called "most appropriate method" rule applies when choosing a transfer pricing method. In other words, after taking into account the nature of the foreign related transactions and the specific functions of the parties involved in the transactions, the most appropriate of the methods listed above should be used.

Difficulty of establishing comparables: When searching for Japanese comparable companies, the ORBIS database provided by Bureau van Dijk is commonly used. Comparables for transactions involving intangibles, such as royalty transactions, are often located using databases specifically containing licensing agreements, such as RoyaltyStat. If it is possible to identify from such a database a royalty transaction between third parties that is comparable to an intercompany royalty transaction, then that comparable transaction can be used in a CUP analysis.

Most licensing agreement databases contain predominately U.S.-based agreements, as the United States has more publicly available information on licensing agreements than any other country. Thus, the agreements available in these databases may be of limited usefulness in other geographic markets such as Japan. However, given the absence of any other comparable transaction information, the transactions from such databases can sometimes be used in transfer pricing analysis in Japan.

Marketing intangibles issue for brands: When an attribution of intangibles is examined under Japanese transfer pricing legislation, four factors are taken into consideration: decision-making, burden of expenses, provision of services and risk management. In the luxury and fashion industry, when a Japanese subsidiary performs a function to expand advertising and distribution channels and bears the expenditure, attribution of marketing intangibles becomes an issue. If these intangibles are accepted as attributable to the Japanese subsidiary, the profit split method is applied. Caution is necessary, however, because there is a possibility that the Japanese tax authorities will undervalue expenses that may be regarded as an attribution factor to the brand owner. It is necessary to clarify in advance the status of payments to the third parties concerning advertising, promotional and events expenses, by way of robust agreements between the related parties.

Flagship stores/Joint ventures: Several international brands have partnered with Japanese companies to form successful joint venture operations in Japan. Notable examples include:

- Max Mara and Harrods, who have each partnered with SANKI SHOJI Co., Ltd to form Max Mara Japan Co., Ltd and Knightsbridge International Corp., respectively;

- Laura Ashley Japan Co., Ltd, the joint venture between Laura Ashley and AEON Co., Ltd;
- Acne Studios' partnership with TOMORROWLAND Co., Ltd;
- Marc Jacobs Japan KK, the joint venture between Marc Jacobs International and Sumitomo Corporation; and
- the former successful partnership between Coach and Sumitomo corporation to form Coach Japan, which came to an end in 2005, when Coach Inc. purchased Sumitomo's share in the Japanese venture.

A potential issue arises where the Japanese partner assumes practical direction of the joint venture in Japan. Specifically, royalty payments into Japan may be regarded as a foreign related transaction under Japanese transfer pricing legislation, with resulting tax exposure for the Japanese partner in the home country of the foreign partner. Advice should be obtained prior to setting up a joint venture to minimize potential risks in this regard.

Period of NOLs: NOLs can be carried forward for up to nine years. For large-sized corporations (i.e., those with stated capital as at year-end over JPY100 million, or those whose 100 percent parent's stated capital is JPY 500 million or more), the utilization of NOLs is restricted to 80 percent of taxable income.

Financing/reclassification: Financing can be by way of a cash (or in-kind) contribution or loan. Withholding tax rates on dividend and interest on loans are 20.42 percent, which can be reduced or exempted by tax treaty.

The debt/equity ratio of Japan's thin capitalization rule is 3:1. In addition, Japan's 2012 tax legislation included a new earnings stripping regime designed to limit interest deductions effective from fiscal years beginning on or after 1 April 1 2013. The earnings stripping rules do not apply if either:

- the net interest paid to related parties is equal to or less than JPY 10 million in the relevant fiscal year; or
- the interest expense to related parties (net of interest already subject to Corporation Tax in Japan in the hands of the recipient) is 50 percent or less of the entity's total interest expense in the relevant fiscal year.

Where both the new earnings stripping rules and the existing thin capitalization rules apply to limit available tax deductions, the appropriate method to apply will be the one that yields the highest rate of disallowed interest expense. Additionally, in determining the appropriate rate of interest in a related party financing arrangement, Japanese transfer pricing rules, which contain detailed rules for setting interest rates in related party transactions, should be considered.

Transfer Pricing Reporting and Documentary Requirements: Corporate taxpayers are required to report certain transfer pricing-related matters on their corporate tax returns and must observe general record maintenance requirements. While an implied obligation has always existed in Japan with respect to documentation, a statute-based contemporaneous documentation requirement was introduced in 2010, with the amendment of the STML. Failure to adhere to the contemporaneous documentation rules will result in a deemed assessment. Enforcement Ordinance 22-10 includes a comprehensive list of documents related to intercompany transactions and calculation of an arm's-length price that must be provided in order to avoid the deemed assessment.

Advance Pricing Agreements: An APA program was introduced in Japan in 1987, and is frequently used by taxpayers. For example, between July 2012 and June 2013, Japan's taxing authority, the National Tax Agency (NTA) received 131 new bilateral APA applications, with 129 bilateral APA cases disposed of in the same period. "Cases disposed of" includes mutual agreements concluded between Japan and treaty partners for APAs, as well as cases withdrawn in the period. In principle, the rules provide that an APA may be from three years to five years in length. In practice, however, the term of an APA will vary depending on the needs of the taxpayer concerned.

Potential application of corporate donation theory: Corporate gift or donation transactions (which may include the transfer of assets or benefits without consideration, or for a lower or higher amount than fair market value) between corporations gives rise to double taxation: i.e., the gift or donation is taxable to both the donor, which must recognize a non-deductible donation, and the donee, which is required to recognize taxable corporate gift gain. In the case of wholly owned group companies, this rule has been relaxed to relieve the donee from the requirement to recognize a taxable gift gain, provided the donor recognizes a non-deductible donation. When a brand owner manages and directs advertising, promotion, marketing, parties, events, etc., and its Japanese subsidiary pays for the resulting expenses, careful preparation of robust agreements is imperative to show that such activities are beneficial in Japan, to avoid the double taxation trap.

2. Tax Controversies

Identification of Companies for Audit: In Japan, the criteria for selecting a taxpayer for audit by the NTA are not a matter of public record. In the past, many observers had indicated that larger companies were more likely to be selected for audit than medium or small companies -- this is no longer necessarily the case. The TRTB's recent targets have included small and medium companies, and many assessments of such companies have been made.

Under the Japanese Tax Audit Law, double jeopardy is not prohibited. A series of investigations uncovering nothing of concern to auditors would not preclude an entity from further audits until the relevant limitations period closes but further audits are generally not conducted in practice.

Audit procedure: Normally, advance notice and a request for cooperation are served on a taxpayer that has been selected for audit. The notice states the fiscal years of interest to auditors, the general purpose of the audit (including the NTA's reason for conducting the audit and what it expects to find or clarify), the expected length of time of the audit, and the names of the NTA officers in charge of the audit. Under the relevant provisions, the inspector must notify a taxpayer or its representative of the intent of the audit prior to commencing the audit.

At the end of the audit, the inspector usually gives an explanation of the results and his or her opinion to a representative of the taxpayer company. If the audit has found inconsistent or incorrect tax accounting, the inspector will request that the company submit an amended tax return. The company is, however, entitled to object to the investigator's findings. The auditor will discuss such an objection with the taxpayer and, in some cases, may withdraw his or her findings. If an inconsistency remains between the auditor's position and the company's position, and the company does not voluntarily submit an amended tax return, a formal reassessment would be made by the NTA. There is no express provision in Japanese tax law allowing the tax authorities to settle a dispute.

Appeals: An appeal to a notice of deficiency is generally a two-step process, beginning with an appeal to the chief of the local tax office, followed by an appeal to the National Tax Tribunal (NTT). As a general rule, a notice of deficiency issued by the chief of a local tax office should be appealed, in most cases, to the chief of the local tax office that issued the deficiency in the first instance, and an appeal to the NTT is only available after the appeal to the chief of the local tax office is rejected or no decision is made within three months from the date immediately following the date of the local tax office appeal. That said, "blue return" taxpayers (which accounts for most corporate taxpayers) can in most cases appeal directly to the NTT.

A taxpayer that is dissatisfied with the decision of the NTT may appeal that decision in the regular Japanese court system. The NTA is not permitted to appeal decisions of the NTT. The taxpayer may bring suit in certain other cases as well, including when the NTT makes no decision within three months after the filing of a written protest.

Competent authority procedures: Japan's tax treaties provide for competent authority proceedings in the manner found in OECD-type tax treaties. The NTA's Office of Mutual Agreement Procedures (OMAP) is in charge of Japanese competent authority procedures, as well as APAs and tax treaty negotiations.

Collateral adjustments are permitted to avoid double taxation. However, set-offs or netting between years (e.g., netting transfer price overshooting and undershooting between years to determine a net adjustment) is not contemplated in Japanese transfer pricing rules. However, these adjustments may effectively occur informally in the audit context. Japanese domestic law does not provide for resolution of tax disputes by means of arbitration or mediation procedures.

3. International/Regional Concerns

Corporate tax: The effective corporate tax rate for a large company based in Tokyo, taking into account corporate tax, business tax, inhabitant's tax, and special local corporate tax, is 38.01 percent during the period that the Special Reconstruction Corporate Tax applies, i.e., from 1 April 2012 to 31 March 2015. The effective rate for SMEs is 16.5 percent on income up to JPY8 million, and 28.05 percent on income exceeding JPY8 million. For fiscal years from 2015 onward, with the sun setting of the Special Reconstruction Corporate Tax, a large company in Tokyo should have an aggregate corporate tax rate of 35.64 percent.

Withholding tax: Japan imposes withholding tax at 20 percent, where a Japanese company pays a dividends, interest or royalty to a non-resident. A 2.1 percent surtax is also applicable to income on dividends, royalties and interest sourced in Japan, although a lower applicable treaty rate (without regard to the Special Reconstruction Income Tax) will generally apply where a treaty is available.

Consumption Tax: On 1 April 2014, Japan's Consumption Tax (JCT) rate increased from a flat 5 percent to a flat 8 percent. The rate is slated to increase again, to 10 percent, effective 1 October 2015, assuming Japan's economic conditions continue to improve. Further changes to Japan's JCT system are also being contemplated that may create additional complexities going forward, including the use of variable tax rates, depending on the goods being purchased, and new invoicing requirements.

Tourists are able to claim a refund of JCT on purchases of duty-free products, such as clothes and electronic equipment, at licensed duty-free stores. In an effort to increase purchase of goods in Japan by foreign tourists, the scope of duty-free products eligible for the JCT refund is to be expanded from 1 October 2014 to include commodities such as cosmetics and certain foods. The government also plans on doubling the number of licensed duty-free shops in Japan.

China

China has rapidly emerged as the dominant force in the international luxury market when overseas buying is taken into account. Flights leaving Hong Kong for China quickly run out of bin space, with the shoppers carrying shopping bags labelled with prominent luxury and fashion brands. Chinese shopping for luxury brands is not confined to Hong Kong. Chinese rank first in duty-free refund lists in London, Paris and Milan airports. The luxury brand shops in Europe have all hired Chinese-speaking sales staff.

In Shanghai, the fashionable road of Huai Hai is lined with the dazzling stores of the luxury brands. Even secondary cities like Wuxi or Suzhou also have vastly more luxury stores than places like Boston or Houston.

China has no special crackdown on luxury producers but, generally, foreign companies that sell premium products imported into China do so at prices that far exceed those in other parts of the world and face ever-increasing pressure from multiple branches of government. In particular, pharmaceutical companies, retailers and automobile companies have been investigated. One leading pharma company was accused of bribing doctors to use their drugs and this investigation has now spread to many other leading MNCs. China is the world's largest auto market and one of the largest markets for prestige brands. China is also one of the world's biggest and most profitable market. Antitrust investigations have been launched, as auto prices in China can easily be double those of the west, with custom duties and other taxes not being sufficient to explain the premiums. Traditional luxury companies have not been targeted; yet, they are not viewed favorably. They entered China forcefully with China's 2001 accession to WTO, where China was forced to accept foreign fully owned retailers as a condition of accession.

The Chinese government is not pleased with the diversion of a vast amount of the population's savings into luxury brands. Recent crackdowns by President Xi Jinping on corruption has seen watches and bottles of wine retailing for more than US$ 1,000. But, surprisingly, the shoppers coming in from overseas are not stopped by customs, so there is a leakage of taxes of enormous proportions. Why this is so and how long it will continue is a big question.

At the same time, consumption in China is shifting, with women's categories and fashion becoming more prominent, as a result of Chinese shoppers becoming more sophisticated. These shifts are an extension of trends that began at the end of 2012; they are creating new imperatives for brands as they re-examine their operations in China, from pricing, to customer relationships, to fashion content, and to local talent management. The anti-corruption and frugality campaign had a large impact on "gifting luxury", with watches and men's wear most impacted.

As China's domestic luxury market evolves, there are four changes that are adding complexity:

- Store expansion is no longer enough to drive growth. The number of new openings by global brands in China declined by one-third this year to roughly 100, from 150 last year, for the 20 brands.

- Consumer segments are more complex. Reaching these diverse segments forces brands to be more nuanced in their approach to shoppers and in their offerings than ever before.
- Marketing and sales channels are quickly shifting as well. Chinese shoppers are extremely well informed. Seventy-three percent of consumers use the internet to get information about luxury goods purchases before they buy.
- The market is polarizing at the highest and lowest ends of the luxury products spectrum. For example, in handbags, 25 percent of models from luxury brands fall under RMB 5,000, while 33 percent fall over RMB 20,000.

The importance of the Chinese consumer to the global luxury sector continued to increase, accounting for 29 percent of global luxury spend in 2013, up from 25 percent in 2012. Top global luxury brands with their world-class, state-of-the-art design, quality, and cultural heritage continue to attract newly wealthy Chinese customers:

- Salvatore Ferragamo: Based on its “Made in Italy” excellence, it has enjoyed 20 percent sales growth in 2013.[48] China has been on the rise for Ferragamo in the last few years, clocking 44 percent growth in 2011, with 60 monobrand stores in 34 mainland cities.
- Burberry: Mainland China delivered 11 percent comparable sales growth, and external revenues derived from customers in China for the year to 31 March 2014 is £318.2 million.
- Pernod Ricard: According to its annual report,[49] the liquor company is number one in China by “western-standards, especially high-end cognac volumes. It has also acquired a vineyard located in Helan Mountain, which accounts for 6 percent of its total 6,660 global vineyard hectares.
- Cartier: It is the number one luxury jewelry brand in China and has 35 percent of its revenue coming from the country. The company has 39 mainland boutiques and 11 Hong Kong boutiques.
- Tiffany & Co.: Greater China represents more than 12 percent of its worldwide sales. It operates 26 stores in mainland China, four of which were opened in 2013; and nine in Hong Kong, two in Macau and eight in Taiwan.[50]

1. Transfer Pricing and Other Issues

Overview of Rules: The main tax authority in China is the State Administration of Taxation (SAT), located in Beijing. The SAT is below the ministerial level but is one of the administrative bodies directly under the State Council. Its main function is to set policy and develop legislation, as well as to supervise the Provincial Tax Bureaus and to conduct a competent authority process for those tax authorities. Transfer pricing falls under the responsibility of the LTB authorities. In China there are 22 provinces, five autonomous regions and four municipalities.

China is not a member of the OECD, but is part of the “Enhanced Engagement” program. However, China’s transfer pricing legislation has drawn upon the OECD Transfer Pricing

[48] Fashionista.com; http://fashionista.com/#!/2014/01/ferragamo-china-ready-to-wear#!
[49] Pernod Ricard Registration Document 2012/2013, pp. 2, 61.
[50] Tiffany & Co., Form 10-K, p. k-4.

Guidelines for transfer pricing methodology, comparability analysis, documentation and the APA process.

On 9 January 2009, the SAT released "Implementation Measures for Special Tax Adjustments" (Circular 2). The Final STA Measures contain 13 chapters and 118 articles. "Special tax adjustments" refer to "tax avoidance" associated with: (i) transfer pricing; (ii) use of tax havens via Controlled Foreign Corporations (CFCs); and (iii) sham arrangements entered into solely for tax evasion. Policies designed to crack down on these policies are known in China as "anti-avoidance". In other words, transfer pricing adjustments are a subset of special tax adjustments.

Circular 2 is the landmark TP regulation for China and it establishes a broad and comprehensive framework for the implementation of transfer pricing regulation in the country. It effectively supersedes all prior regulations, although it does not change many of those principles that have previously been in place. For example, it continues to endorse the arm's-length principle and supports the use of APAs. It does, however, introduce a number of new elements, such as documentation requirements and cost sharing. Circular 2 is divided into 13 chapters, each of which addresses a specific area.

Circular No. 363 issued by the China SAT ("Strengthening the Monitoring and Investigation of Cross- Border Related Party Transactions", *Guo Shui Han [2009] No. 363, 7/6/09*) states that loss-making entities must prepare documentation if they are limited function. Circular 363 further tightens the net by stating that limited function entities "shall not bear financial crisis, market and decision-making risks and, in keeping with the transfer pricing principle of correspondence between function/risks and profit, shall maintain a reasonable profit level".

In recent years, China has contended that the transfer pricing policies of multinationals do not consider the full value chain and the Chinese contribution, but simply target a profit based only on comparables. After the publishing of OECD BEPS, China will have a full window into the global value chain. The country-by-country template will show how much profit is being booked into the overseas China principal, and the taxes and head counts. Any lack of substance or evidence of profit shifting to so called tax havens would become glaringly obvious.

For example, in Jiangsu province, where a lot of major multinationals are located, the tax bureau issued in 2013 an administrative plan regarding BEPS, stating that it has reached the following understanding of the BEPS report and will take action accordingly:

- it will consider fully the role of the market in value creation;
- the rights to tax are to be aligned with the substance of economic activities;
- the location of an enterprise's business activities is to be in conformity with the location of its report for tax purpose;
- it will improve the transparency of transfer pricing documentation;
- it will revisit the right to tax of the source in the digital economy;
- it will pay attention to the application of safe harbor rules in transfer pricing; and
- enterprises should strengthen their tax governance and internal control;

The tax bureau of Jiangsu has appeared to have taken an aggressive approach in enforcing this.

<u>Difficulty of Establishing Comparables</u>: Comparable companies have been embraced by western MNEs and been significant in setting the rate of return for their Chinese subsidiaries. But after 10 years of losing arguments about "Whose comparables are better?", the Chinese tax

authorities are signaling that they are not impressed. The SAT states that when non-Chinese comparables are used there should be some adjustment made because these comparables may come from countries like Japan, where the economy is developed and, as a consequence, inflation rates are low, risk rates are low and therefore the overall profit rate is low. To quote the China chapter: "Therein lies one of the key challenges for a developing country – a lack of reliable, public information on comparables. For a developing country, there are usually only a small number of public companies, while information on domestic private companies is lacking or inadequate."

One problem in identifying Chinese comparables is that some Chinese companies are incorporated outside of China (e.g., Cayman Islands) for tax or other reasons and that are listed mainly on a foreign exchange. Traditional searches may not locate such companies. Indeed, most of the famous Chinese hi-tech companies are listed on NASDAQ.

<u>Marketing Intangibles Issues for Brands:</u> In the UN Manual, China introduced the concept of market premium. Companies who benefit from the China market boom must be prepared to pay more in tax. According to SAT, "Market premium relates to the additional profit derived by a multinational company by operating in a jurisdiction with unique qualities impacting on the sale and demand of a service or product."

In practice, because marketing premium is difficult to calculate, the SAT has asked for a premium of five to 10 points above the comparable results. For example, in a recent negotiation, the taxpayer agreed to a distribution operating margin of 11 percent, higher than the typical rate of 5 percent.

The Beijing office of China's State Administration of Taxation received a payment of nearly US$163 million from a Beijing subsidiary of an unidentified MNE, the country's single largest transfer pricing tax adjustment payment to date. The news was reported in the 17 May 2013 *People's Daily*, an official newspaper of the Central Committee of the Communist Party of China.

China tax authorities continue to strongly believe that local Chinese entities have developed "local marketing intangibles" via their marketing efforts and therefore commonly challenge mechanisms (such as royalties) for returning residual profits to the global brand owners. This may be particularly likely where the local Chinese entity appears to have "invested" in developing the China market, as evidenced by losses during the early years of operations. Here, consideration may be given to the implementation of support payments to the local Chinese entities to reduce the risk of locally developed intangibles. These arrangements may also offer opportunities to utilize tax losses in other jurisdictions, therefore potentially improving the group's overall tax efficiency.[51]

<u>Royalties Paid to Overseas Related Parties:</u> Companies who benefit from the China market boom must get ready to pay more in taxes. At the SAT training, it was debated whether additional profit enjoyed by the auto multinationals should be paid out as royalties (as the companies wanted) or locally taxed. In the China chapter, the SAT clearly suggests the latter.

MNEs also need to backstop their defense of their royalty policies. According to the SAT, "it may not be reasonable for the Chinese affiliate to continue paying the same royalty in 2012 (as in 2002) without revising whether the intangible has continued to provide the same value over time".

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[51] (*Global Reach of China Luxury*, KPMG, 2012).

An unidentified foreign investment enterprise was recently assessed as owing more than CNY23 million (about US$3.74 million) in enterprise income tax in China, after the Chengdu National Tax Bureau in Sichuan Province denied a tax deduction of nearly CNY100 million (about US$16.26 million) for royalties paid by the FIE to a related party in the British Virgin Islands between 2008 and 2012 for the use of a trademark. The tax bureau determined that the profits arising from the value of the trademark were allocated to the assessee in accordance with the matching principle of costs and benefits, and that the FIE should not have paid any royalties to the licensor. The tax bureau rejected the assessee's deduction of the royalty payments and adjusted the company's transfer pricing calculation accordingly.

Flagship Store Tax Issues: Flagship stores are core stores for brand name retailers, larger than their standard outlets and stocking greater inventory, and often found in prominent shopping districts. Therefore, the stores have to pay high rent. For example, the monthly rent for a prominent luxury brand flagship store in Shanghai's International Financial Center is about US$300,000 per month. In September 2004, LVMH opened the first flagship store in Shanghai. Gucci entered the Chinese market in 1996 and has 59 flagship stores in the mainland. Hermès has 24 flagship stores in the mainland, and in June 1997, it opened its first flagship store in Beijing's Wangfujin. Chanel opened its first flagship store in Beijing Peninsula Hotel in 1999 and has 11 flagship stores in mainland China. Between 2013 to 2014, Burberry opened a net 20 stores in emerging markets, bringing the total number to 193. However, based on a recent survey from the world luxury association, the sluggish market also kept inventories high in the luxury stores in the major cities, including Beijing, Shanghai, Chongqing and Shenzhen. Visits to these shops declined during the 2014 Spring Festival, in spite of widespread promotion of discounted goods. The SAT might raise questions concerning compensation for flagship stores: namely, who would bear the cost of flagship stores, the distributor, the brand owner or both?

Period of NOLs: According to the "Law of the People's Republic of China on Enterprise Income Tax, Order of the President [2007] No. 63", losses may be carried forward for five years after the tax year in which they are generated. Loss carry-backs are not allowed. The losses of a Chinese enterprise's foreign branches may not be set against its domestic profits.

Financing: There is no specific finance rule for the luxury and fashion industry, but there is a thin capitalization requirement. There has been considerable attention paid to Circular 121 issued on 23 September 2008 by the MOF and the SAT. The circular set the maximum debt-to-equity ratio for financial enterprises at 5:1 and for all other enterprises at 2:1. Any interest paid on debt to related parties that exceeds the ratio shall be non-deductible. However, an exception is that if the loan terms are arm's length, then the interest is deductible even if the 2:1 ratio has been exceeded. Companies with ratios in excess of 2:1 need to prepare thin capitalization documentation.

Value Added Tax: According to "Interim Value-Added Tax ('VAT') Regulations of the People's Republic of China, Order of the State Council No. 538", sales of luxury goods in China are subject to VAT. VAT is also levied on the import of luxury goods into China, unless the imports are specifically exempted under special rules. The standard VAT rate for general VAT taxpayers is 17 percent, and such taxpayers may utilize input VAT credits to offset against output VAT. The standard VAT rate for small-scale VAT taxpayers is 3 percent and no input credits are available. In general, exports are exempted from VAT, and the related input VAT may be wholly or partially refunded. The non-refundable portion is absorbed as a cost of export.

In addition to VAT, there is a consumption tax imposed upon the manufacture, commission processing, importation and sale of certain luxury goods within the territory of China. For example, luxury cigars are subject to 36 percent consumption tax, cosmetics (including luxury skin care cosmetics) 30 percent, luxury ornaments, pearls, jewels and jade 5 to 10 percent, fine wines/champagne and spirits 10 percent and luxury watches 20 percent. There is also custom duty imposed on the imported luxury goods at different rates, depending on tariff classification of the goods.

2. Tax Controversies

Transfer pricing enquiry: Under Chinese law, the statute of limitation for transfer pricing adjustments is 10 years. The number of audits has been increasing rapidly over the years and shifted to focus on large taxpayers, MNCs in particular. SAT also has the ability to pool its nationwide resources to conduct nationwide audits on all associated enterprises of a MNE in China. If not prepared, MNCs may face high risks of double taxation in China and their home country, due to inconsistent transfer pricing rules. In 2012, the SAT authorized 233 new anti-avoidance audits, which included transfer pricing audits, and closed 175 audits. The additional tax collected through transfer pricing adjustments was RMB 4.6 billion, equivalent to US$700 million. This amount accounts for 0.2 percent of the enterprise income tax revenue, which in turn accounts for 20 percent of total tax revenue. There were 26 competent authority cases, which resulted in 11 bilateral advance pricing arrangements (BAPAs) and 11 mutual adjustment agreements.

If audited, the first line of defense is settlement. Taxpayers commonly negotiate with the tax bureaus during tax audits. The settlement result will depend on the taxpayer's bargaining power and how well the taxpayer can defend its position. To create more fruitful discussions with the tax authorities, the taxpayer should have a positive strategy to advance in the negotiation, rather than just responding to the questions and arguments from the tax authorities. During the negotiation, the taxpayer should take a proactive approach to lead the discussion in a favorable direction by presenting its positions and arguments politely but firmly. Because transfer pricing adjustments normally cover a long period of time and involve a large amount of taxes, taxpayers should consider administrative review if negotiations with the local tax bureau do not reach a satisfactory conclusion.

Alternative Dispute Resolution: In 2012, the SAT established an Administrative Appeal Committee to review cases that reach the SAT level. This new committee shows that the SAT will take administrative review seriously. However, some have suggested that it would be more efficient for the SAT to handle all transfer pricing administrative review cases. According to this view, the lower level tax bureau will likely be reluctant to overturn a transfer pricing adjustment because all transfer pricing adjustments are approved by the SAT. In other words, it will take an SAT review to overturn an SAT approved decision. Therefore, the SAT is being encouraged to centralize all administrative reviews of transfer pricing cases with it.

In addition to the domestic dispute resolution mechanism, there are two cross-border dispute resolution mechanisms available for transfer pricing: competent authority procedures and BAPAs. Although under-utilized, these cross-border dispute resolution mechanisms have been playing a very important role in resolving disputes.

The competent authority procedure is a powerful alternative for large MNCs when dealing with a transfer pricing dispute. Taxpayers must apply to the SAT or the competent authority in the taxpayer's home jurisdiction to initiate the competent authority procedure after an adjustment has been made against the taxpayer. Because the competent authority procedure for transfer pricing deals with cases where double taxation has already occurred, the SAT has given priority to this procedure over BAPAs under its international program. Nearly all cases going through the competent authority procedure have been resolved.

BAPA is generally a forward looking mechanism used to prevent disputes occurring. However, in practice, BAPA can also be applied retroactively to solve disputes. The SAT is now overloaded with BAPA applications, as the SAT's international program is seriously under-resourced, both in terms of staff and budget. Nevertheless, the SAT still accepts new BAPA applications, although quite selectively. Applications with a large amount of tax at stake and that have novel issues involved still have a decent chance of being accepted.

To summarize, an MNC that completely ignores the SAT's transfer pricing signals will place itself at significant risk in the future, but overreaction is equally as misguided as inaction. The appropriate response at this stage is to finetune current tax strategies, incorporate precautionary measures, and approach transfer pricing audits with extra care and preparation.

Australia

The international luxury and fashion industry has expanded its presence in Australia in recent years. It has achieved particularly rapid growth stemming from growing wages, high consumer sentiment, and Australia's relative insulation from the global financial crisis. Flagship stores for luxury brands are being set up in tourist hot spots, as they are seen as crucial to capturing the significant and continually increasing Asian tourist market.

The vast majority of luxury and fashion items sold in Australia are manufactured overseas. Global companies in this industry sell finished products to their Australian subsidiary for resale to end consumers and/or wholesale customers. A frequently encountered issue is the appropriate reward to be provided to an Australian subsidiary incurring marketing expenditure in developing an international brand.

1. Transfer Pricing and Other Issues

Overview of Rules: Australia's transfer pricing laws have recently undergone significant amendments in order to further modernize and align Australia's transfer pricing laws with international standards (including the OECD Transfer Pricing Guidelines) but also to entrench a reconstruction-style regime in the law. The new laws require entities to hypothesize on the arm's-length conditions that would have operated between independent entities in similar circumstances, based on the commercial or financial relations in connection with which the actual conditions operate, and having regard to both the form and economic substance of the relations.

Australian Taxation Office (ATO) disclosure: The ATO requires an International Dealing Schedule and/or a reportable tax position schedule (RTPS) to be completed and lodged by the relevant taxpayers. These schedules assist the ATO to identify profit-shifting risks and select cases for reviews or audits. The ATO also requires large businesses to disclose their most contestable and material tax positions in a RTPS, to be attached to their annual income statements.

Documentation: Australian companies are strongly encouraged to prepare contemporaneous transfer pricing documentation evidencing related party international dealings and to document the process used to select and apply the most appropriate arm's-length methodologies, so that the risk of an audit is minimized and they are able to establish a reasonably arguable position (which may reduce penalties in the situation of a tax shortfall).

Difficulty of Establishing Comparables: The overriding consideration governing the ATO's approach is the application of the arm's-length principle to identify what would have been agreed between independent enterprises dealing at arm's length in similar circumstances. Key to this is an analysis of the actual contractual arrangements and comparable independent entities, identifying the contractual costs, risks and benefits of the marketing activities. Difficulties can arise where entities do not engage in corresponding independent wholesale distribution (which may offer appropriate comparables), as it may be difficult to find other global luxury and fashion brands with a similar presence in Australia and with similar functions, assets and risks. Hence, it may be difficult to establish arm's-length consideration for the distribution function separate from the marketing function. The more extensive the marketing functions are, the less likely sufficient reliable comparables will exist.

Marketing Intangibles Issue for Brands: Following on from the discussion in this chapter, the appropriate reward for marketing expenditure of a local subsidiary to develop a brand its offshore parent owns has received particular attention from the ATO. Where the Australian subsidiary bears the costs and risks of marketing, the issue will be the extent to which the subsidiary can share in the benefits of the marketing activity. The ATO notes that this analysis may be further complicated when there is no clear distinction between marketing and distribution activities.

Flagship Store Tax Issues: As luxury and fashion companies use retail presence as branding statements separate from other media marketing campaigns, issues relating to flagship stores center on who bears the costs and what is the appropriate reward for setting up and running flagship stores. This issue will increasingly arise as flagship stores are set up to capture the increasing lucrative tourist dollar, which is considered to contribute as much as 30 percent of total luxury industry revenue, mainly from Asian tourists.[52]

Period of NOLs: Although there is no strict temporal rule on how long an entity may have NOLs, businesses that consistently return losses or below-industry returns will trigger ATO attention and potential risk reviews and audits. It is therefore exceptionally important that businesses that are returning losses or below-industry returns prepare adequate documentation evidencing their international dealings.

Financing/Reclassification: Australia's thin capitalization rules operate to disallow debt deductions that an entity can claim when the entity's debt to equity ratio exceeds certain limits, in order to discourage entities from adopting cross-border investments with highly geared structures to avoid taxation. The ATO considers that rules relevant to deductibility, including transfer pricing, must be applied before thin capitalization is considered. Withholding tax rates on dividends, interest and royalties paid to non-residents vary depending on whether the non-resident is a resident of a treaty country or not, and if they are resident of a treaty country, what treaty country they are from.

[52] IBIS, *Luxury Retailing in Australia Report*, page 6.

2. Tax Controversies

Summary of Above Issues: Australia has robust corporate tax rules and compliance arrangements and there is insufficient proof of widespread erosion of Australia's corporate tax base at present, although arguably there is growing anecdotal evidence. The Australian Government views the OECD's BERS project as a significant risk and is using its current G20 Presidency to advocate international transfer pricing reform. The ATO has also been increasingly active in the area locally and with the OECD.

Transfer Pricing Risk Reviews and Audits: ATO resources for transfer pricing are allocated based on perceived risk. Businesses with significant levels of international dealings with associated enterprises, which are consistently returning losses or below-industry returns, are involved in business restructures, intra-group financing or operate in certain higher risk industry sectors, are at the highest risk of an ATO transfer pricing review.

The ATO will generally undertake a risk review before deciding to proceed with a transfer pricing audit. As part of its review, the ATO will examine related party international dealings, and the quality of the business's processes and documentation, as well as the commercial realism of the outcomes of its dealings. Businesses are advised of the outcomes of the review, and provided a risk ranking accordingly.

When the ATO commences a transfer pricing audit and concludes that there is a material difference between the results of its analysis and that of the taxpayer, a transfer pricing adjustment may be proposed. There is also a risk that penalties will be imposed.

Alternative Dispute Resolutions: Under its general powers, the Commissioner of Taxation is able to engage in alternative dispute resolution as an alternative to formal dispute processes. A range of alternative dispute resolution approaches, including mediation, are available, to assist in reaching settlement.

Advance Pricing Arrangements: The ATO offers an APA program to provide taxpayers with an opportunity to reach agreement with it on the method of application of the arm's length-principle to their international related party dealings on a prospective basis, in order to reduce uncertainty for the taxpayer. An APA will generally apply for three to five years, and can be concluded unilaterally, bilaterally or multilaterally. The ATO has recently streamlined its APA program to provide simple, standard and complex APA options.

3. International/Regional Concerns

The development of brands in the luxury and fashion industry in Australia is becoming increasingly significant, and transfer pricing issues center around valuing and rewarding the marketing intangibles. ATO guidance focusses on identifying actual and comparable contractual arrangements; whether the level of marketing activities performed exceeds that performed by independent enterprises; the extent to which marketing activities would benefit the parent company and local subsidiary as individual entities; and the proper compensation allocated for marketing activities. The overriding consideration is always the application of the arm's-length principle.

Hong Kong

With the continued growth in mainland Chinese tourist arrivals, Hong Kong has remained an attractive destination for international luxury brands.

Hong Kong adopts a territorial source principle of taxation. It does not impose any form of sales tax or VAT. Apart from duty imposed on very few commodities, such as alcohol or tobacco, there are no customs duties. This means that only profits arising in or deriving from Hong Kong are taxable in Hong Kong. As a result, there are really two main issues faced by the luxury and fashion industry in Hong Kong. The first is the tax treatment of royalty payments and the second is transfer pricing. With the former issue, the concern is that royalty payments received by an overseas entity with no presence in Hong Kong from a Hong Kong entity may be deemed profits assessable in Hong Kong. This deemed profit on the offshore entity is taxed by way of a withholding tax on the royalty payment. As for transfer pricing, unlike other major jurisdictions, Hong Kong does not have specific transfer pricing legislation. The Inland Revenue Department (IRD) has only recently issued its views on transfer pricing, and clarified that Hong Kong generally follows the OECD principles and guidelines. The APA program is likewise relatively new and so far Hong Kong has only concluded one APA.

1. Royalties – Deemed Profits

In general, only Hong Kong-sourced profits arising from a business carried on in Hong Kong are taxable. Nevertheless, royalties (payments for the right to use most types of intellectual property) received by the overseas company with no presence in Hong Kong and who do not carry on business in Hong Kong are deemed to arise in or derive from a business carried on in Hong Kong. The assessable profit is generally 30 percent of the payment. In the absence of a treaty, this produces a withholding tax rate of 4.95 percent under current law (profits tax rate of 16.5% x 30% = 4.95%). Where the payment is to be paid to an associate of the payer, and if the relevant intellectual property has at any time wholly or partly been owned by a person carrying on business in Hong Kong, 100 percent of the profits are deemed assessable. This produces an effective withholding tax rate of 16.5 percent (16.5% x 100%), subject again to treaty. The Hong Kong payer would be subject to the withholding obligation. Confirmation of whether the lower rate applies may be obtained by way of advance ruling from the IRD, although most taxpayers do not obtain a ruling on this issue.

2. Transfer Pricing

Overview of Rules: The Hong Kong legislation does not contain specific provisions targeting transfer pricing. While there are provisions that prohibit non-arm's length payments to an associated company on the grounds that the payments are not for the purposes of trade, the transfer pricing framework is set out in the IRD's Departmental Interpretation and Practice Notes (DIPN) No. 46, which indicate the IRD's views on transfer pricing methodologies and related issues. In general, the IRD adopts the OECD's transfer pricing principles and methods. DIPN No. 46 identifies the five transfer pricing methods specified in the OECD Guidelines while also allowing for unspecified methods to be applied. There is no priority of methods; the most appropriate methodology should be used, taking into account the comparability analysis and the availability of information, though traditional methods are preferred over profit-based methods. The IRD will apply the arm's-length principle to determine the appropriate price for transactions between associated enterprises; however, DIPN No. 46 states that the sourcing principle will primarily be used to determine whether profits are taxable in Hong Kong. The main issue with transfer pricing in Hong Kong is the absence of a legislative framework, since the DIPN is an expression of policy only and is not binding on the IRD or the taxpayer as a matter of law.

<u>Enforcement and Other Issues:</u> The usual transfer pricing enforcement approach of the IRD is to invoke the general anti-avoidance provisions in the current legislation to set new prices, on the theory that non-arm's-length prices reflect transactions where the sole or dominant purpose was to avoid tax. The IRD will also consider requests for appropriate adjustment to the amount of tax charged under the relevant transfer pricing article in double taxation agreements, which allows the IRD to adjust the profits of the Hong Kong entity if they are not consistent with the arm's-length principle. At present, Hong Kong has concluded treaties with Austria, Belgium, Brunei, Canada, Czech Republic, France, Guernsey, Hungary, Indonesia, Ireland, Italy, Japan, Jersey, Korea, Kuwait, Liechtenstein, Luxembourg, Malaysia, Malta, Mexico, the Netherlands, New Zealand, Portugal, Qatar, Spain, Switzerland, Thailand, the United Kingdom and Vietnam. The IRD will generally not consider requests for transfer pricing adjustments in respect of jurisdictions that do not have a treaty with Hong Kong. The statutory limitation period for raising additional assessment(s) is six years after the end of that year of assessment.

<u>Documentation:</u> There is no mandatory requirement for transfer pricing documentation, though it is recommended by the IRD. The information required by the IRD in an audit normally includes (a) nature, terms, prices and quantum of relevant transactions, including transactions that form a series and any relevant offsets; (b) the method or methods by which the nature, terms and quantum of relevant transactions were arrived at, including any study of comparables undertaken; (c) the way the selected method has resulted in arm's-length terms, etc., or where it has not, the computational adjustment required and how it has been calculated, which usually includes an analysis of market data or other information on third-party comparables; (d) the terms of relevant commercial arrangements with both third party and group customers.

<u>APA</u>. In 2012, Hong Kong introduced an APA framework to provide taxpayers with an alternative for resolving transfer pricing issues. The framework is outlined in DIPN No. 48, which stipulates a five-stage application process. The program is open to all residents and non-residents with a permanent establishment in Hong Kong, who are subject to profits tax and have related transactions relevant to Hong Kong. The scope is focused on the negotiation of bilateral and multilateral APAs where Hong Kong has a double taxation agreement with the counterparty jurisdiction(s). Unilateral APAs are possible where the treaty partner does not wish to participate, negotiations with the treaty partner has collapsed, or when a non-treaty state is willing to enter into a unilateral APA for transactions that are integrally linked to the covered transactions in a bilateral or multilateral APA. The program is targeted at complex controlled transactions. To qualify, there is a threshold between HK$20 to 80 million per annum for each year covered in the APA, depending on the nature of the transaction. As the program is relatively new, Hong Kong only recently concluded its first bilateral APA, in June 2014.

India

In recent years, the Indian fashion retail market has witnessed several changes and challenges, which are indicators of the country's evolving fashion retail market. These changes need to be addressed in the most efficient and prudent manner in order to harness the concomitant benefits.

India is the fifth-largest retail destination globally. The Indian retail industry has experienced tremendous growth over the last decade, with a significant shift towards organized retailing format, and development taking place not just in major cities and metros, but also in Tier II and Tier III cities. The Indian retail market, currently estimated at around US$490 billion, is projected to grow at a compound annual growth rate (CAGR) of 6 percent, to reach US$865 billion by 2023[53]. With the introduction of a large number of international luxury brands to the country, the face of luxury retail in India has undergone a dramatic transformation. The Indian luxury retail market is currently growing at a compounded annual growth rate of 25 percent. India is the future destination for luxury retail brands across the globe and many of these brands are planning huge expansion there. Luxury retail is not limited to foreign brands, as there are many Indian retail brands falling into this category.

1. Transfer Pricing and Other Issues

Overview of the Rules: The Indian Income Tax Act, 1961 (ITA) contains detailed transfer pricing provisions broadly aligned with the OECD Guidelines. Every taxpayer entering into an international transaction with associated enterprises is required to demonstrate the arm's-length nature of such transactions, by way of detailed documentation as prescribed in the regulations. The regulations define terms such as "international transaction", 'associated enterprise", "intangibles", and prescribe documentation requirements, audit procedures and penalties for non-compliance.

Indian transfer pricing regulations prescribe six methods for the computation of the arm's-length price. The legislation warrants that the most appropriate method be selected considering the nature or class of transaction, the functions performed in the course of that transaction and the availability of data to compute the arm's-length price.

In a significant change to the transfer pricing provisions under the ITA, effective 1 April 2013, the provisions also have been extended to cover specified domestic transactions (SDTs). Previously, the specific transfer pricing provisions under the ITA were applicable only to international transactions with associated enterprises.

The ITA lays out 13 conditions for determining whether two enterprises will be deemed to be associated enterprises. One of those 13 conditions mentions that:

> *"(vii) the manufacture or processing of goods or articles or business carried out by one enterprise is* ***wholly dependent upon*** *the use of know-how, patents, copyrights,* ***trade-marks, licenses, franchises, or any other business or commercial rights of similar nature****, or any data, documentation, drawing or specification relating to any patent, invention, model, design, secret formula or process, of which the other enterprise is the owner or has exclusive rights".*

This definition of the deemed associated enterprises will cover the franchise, trademark or licenses arrangements between independent brand licensor and licensee.

[53] http://www.ibef.org/industry/retail-india.aspx

Further, the Finance Act 2012 has amended/expanded the definition of "international transaction", as per section 92B of the ITA, retrospectively with effect from 1 April 2002. The intention was to clarify the meaning of the "international transaction" and specifically cover certain transactions on which applicability of transfer pricing regulations were questioned by the taxpayers/Indian Revenue Authority (IRA). One example is explanation of intangible property (IP) to include marketing intangible, human capital intangible, location related intangible, etc.

Difficulty of establishing comparables: The popular databases used for the search of comparable companies in India are publicly available databases – Prowess and Capitaline. The IRA also has access to these databases. When carrying out benchmarking analysis for transactions that include use of IP, the Indian databases fail to provide sufficient information, like royalty rates, agreements and detailed terms and conditions between independent entities. The basic reason is that in India there is no requirement to file these licenses as a part of any regulatory framework that is available to the public. Some information may be available on the internet, but it may not be complete or reliable. This creates a problem in benchmarking the royalty rates or other payments made by Indian taxpayers for intangibles. Further, the IRA often asks taxpayers to demonstrate tangible benefits received by them from use of such intangibles. The burden of establishing the genuineness of the payments and the arm's-length price of the same is much heavier than for other transactions.

Also, for distributors or manufacturer of luxury and fashion products, it is difficult to find independent Indian companies who are dealing in similar products. This creates a problem of comparing the profitability and prices of a taxpayer who is dealing in branded products accompanied by a license or right to use an IP, with profitability and prices of comparable companies who are dealing in unbranded products. There is an option of making an adjustment on the profitability and prices to eliminate the effect of these differences; however, in practice, it is difficult to determine reasonably accurate adjustments.

In view of the issues involving the development of marketing intangible (which is discussed in the following paragraphs), the IRA determines "the bright line" limit by broadly using the same set of comparable companies selected by the taxpayer for benchmarking its distribution/manufacturing activities. However, the financial statements of comparable companies do not provide accurate bifurcation of AMP expenses into routine and non-routine expenditure.

Marketing Intangibles: Marketing intangibles has become a hotly debated topic in India. Under the IRA, marketing intangibles and their value is derived from the company's levels of AMP expenses. While an enhanced spend on AMP may increase the brand equity of the intellectual property, the local subsidiary may not have the right to future benefits arising from it. Thus, the IRA seeks to identify and differentiate these spends that develop the intangible and provide enduring benefit over that of routine advertising costs. The IRA's contention is that the taxpayer that has incurred significant costs to generate these non-routine intangibles needs to be compensated by its affiliates in other jurisdictions on a cost plus basis.

Flagship Store Tax Issues: The IRA may also question the motive of establishing a flagship store. Generally, these stores are established to generate greater visibility in the local market, rather than profits. Hence, these expenses are added to the AMP expenses incurred by the taxpayers and subject to the "bright line" test by the IRA.

Period of NOLs: ITA allow for losses incurred under various heads to be set-off against other income in the same tax year, or during the course of a specified number of subsequent years, depending on the nature of loss. Under the current provision of the ITA, business losses can be carried forward for a period of eight years, and a depreciation allowance may be carried forward for an indefinite period.

Financing/Reclassification: India does not have any thin capitalization rules under the present tax laws. The debt-equity ratio maintained by a company is purely a commercial decision. However, under the General Anti Avoidance Rules ("GAAR") regime (proposed with an effective date of 1 April 2015) tax allowance of expenses (including interest expenses) can be challenged, to the extent these are tax motivated.

The IRA is, however, increasingly re-characterizing transactions of equity in nature as a hypothetical loan and thereby imputing interest on such loan. Based on an arm's-length determination of the share price, if any shortfall is noted in the consideration that a taxpayer should have received on account of issuance or transfer of shares, such short receipt of share consideration is regarded as a hypothetical loan granted by an Indian taxpayer to its associated enterprise. An interest is therefore computed on such alleged loan as a transfer pricing adjustment.

The sustainability of this adjustment is yet to be tested by the judiciary in India, as the moot questions that arise are whether the Indian transfer pricing regulations allow re-characterization of such capital transactions and/or recognize "hypothetical" transactions at all.

A Tax Court case adjudged in 2010 [*Besix Kier Dabhol SA v. DDIT* (ITAT Mumbai)] held that the IRA could not re-characterize debt into equity and accordingly treat any portion of the interest paid as excessive in the absence of thin capitalization rules in India. The exchange control guidelines in India provide for specific guidance on external commercial borrowings (ECBs) by residents in India from overseas. The guidelines allow borrowings under the automatic approval route if the debt-to-equity ratio is within 4:1. However, no specific limit is provided under the present transfer pricing regulations.

2. Tax Controversies

The main points that trigger tax controversies in India are not so different from the issues raised in other countries and mainly concern, among others, marketing intangibles, comparability of the data used for benchmarking analysis, and the disallowance of IP-related payments based on a benefit test.

Marketing intangibles were focused on in the recent transfer pricing audits in India. The IRA alleges that the significant AMP efforts by the Indian subsidiaries enhance the value of the trademark/brand name that is legally owned by the overseas affiliate. The IRA categorizes the excessive, non-routine marketing efforts of the Indian subsidiaries as a "service" rendered by the overseas affiliate, and accordingly proposes transfer pricing adjustments for compensation that the Indian subsidiaries should have received for their marketing efforts. These adjustments have increased significantly over the years and have hit various taxpayers across industries, especially luxury/fashion/branded products. Taxpayers have been arguing before the IRA and appellate forums on the following grounds:

- powers of the tax officer to assume jurisdiction over the transactions not referred to him;
- whether high AMP spend constitutes a "transaction";

- whether AMP expenditure by an Indian subsidiary can constitute an “international transaction” with its associate enterprises;
- whether the “Bright Line” test is a method prescribed under the ITA to compute arm’s-length price;
- whether high entity level profits justifies high AMP or whether there is a need to look into such spends independent of the level of profits in the Indian subsidiary; and
- scope of AMP expenditure – which expenses should be brought under its ambit.

In India, the issue around marketing intangibles first came up in the case of *Maruti Suzuki India Limited*. The Delhi High Court (HC) had made important observations on the concept of bright line and comparability, but this order was finally quashed by the Supreme Court of India (SC) on technical grounds and hence no jurisprudence emerged. Recently, (in *LG Electronics [TS-11-ITAT-2013(DEL)-TP]*) a Special Bench (SB) of the Delhi Tax Court was constituted to deal with the vexed issue of marketing intangibles, which has impacted several taxpayers. In this ruling, the SB concluded that the transfer pricing adjustments in relation to AMP expenses incurred by Indian subsidiaries for creation/enhancement of marketing intangibles for or on behalf of foreign affiliates is legally permissible under the current scheme of the law. The SB ruled on most of the legal issues in favour of the IRA. Further, it laid down 13 principles for identification of comparables, and provided a restrictive definition of AMP by excluding items such as discounts and commissions offered to dealers.

In a supposed contradiction to the SB ruling, a co-ordinate Bench of Delhi Tax Court in the case of BMW India (*BMW India Pvt. Ltd. [TS-230-ITAT-2013(DEL)-TP]*) ruled that the premium profits earned by the Indian subsidiary of a foreign parent represented an arm’s-length compensation for excessive marketing activities undertaken by it, and hence no further adjustment was required. This had led to confusion on whether the SB ruling was applicable to distributors. Recently, the Delhi Tax Court adjudicated another case (*Bose Corporation India Pvt. Ltd. vs. ACIT [TS-228-ITAT-2014(Del)-TP]*) wherein it held that the view taken in *BMW India*’s ruling was peculiar on its facts and hence in conformity with the decision of the SB. Thus, the Tax Court held that *BMW India* ruling does not override the SB ruling and that there were no conflicts between the decisions.

A similar view has been taken in the United Nations Practical Manual on Transfer Pricing for developing countries (Chapter X – *Emerging Transfer Pricing Challenges in India*), where it is mentioned that Indian subsidiaries incurring AMP expenses, bearing risks and performing functions beyond what an independent comparable company performs should be compensated in the form of reimbursement of excess AMP expenses along with markup, or should be allowed to share profits related to marketing intangibles. It is pertinent to mention that India’s views in Chapter X of the UN Manual are not legally binding on taxpayers in India.

On a related matter, the IRA often questions payments for use of IPs such as royalty, trademark and fees. The IRA demands detailed back-up documents demonstrating tangible benefits the taxpayer has received from the use of such IPs. The IRA specifically questions the royalty rate charged for use of brands, trademarks, etc., wherein significant costs are borne by Indian subsidiaries in the form of AMP to promote and develop customer loyalty and enhance brand value.

3. Alternative Dispute Resolution

Most of the tax treaties signed by India provide for transfer pricing adjustments in relation to transactions between associated enterprises if such transactions are not priced at arm's length. This is typically captured in article 9(1) of the tax treaties. Article 9(2) of the tax treaties provides for a mechanism to resolve economic double taxation that would arise pursuant to a transfer pricing adjustment in one country. In certain cases (such as Germany, Korea and Singapore), article 9(2) is absent. This is increasingly becoming a big issue in the resolution of transfer pricing disputes with these countries.

The Finance Act 2009 granted the Central Board of Direct Taxes (CBDT) the power to articulate safe harbor rules. These rules provide for the minimum margins/norms, in relation to certain categories of international transactions, which would be acceptable to the IRA. The CBDT vide notification dated 18 September 2013 provided the safe harbor rules for the certain industries/services. These rules do not apply to industries specific to any luxury or fashion products.

Further, as part of changes to the Finance Act, 2012, APAs were introduced in India through section 92CC of the ITA. An APA is an arrangement between the taxpayer and the IRA on an appropriate transfer pricing methodology for a set of international transactions that are proposed to be undertaken by a taxpayer over a fixed period of time. It is our understanding that the marketing intangible issues for luxury/fashion products have been raised by certain taxpayers during discussions with the APA authorities. No such APA has been concluded yet.

4. Conclusion

Transfer pricing issues for luxury goods players in India have increasingly been surfacing. While, at a generic level, some changes have been made to the Finance Bill 2014 (such as the use of multiple year data and the introduction of the range concept for determining the arm's-length price), no specific guidance has been provided for this industry. Issues around intangibles are currently being debated at forums like the OECD and, hence, it is reasonable to expect that it would take some time for clear guidance to emerge. Till then, it would be beneficial if the IRA avoids taking aggressive stands and provided some reasonable guidance on how taxpayers in India are expected to comply with the arm's-length principle.

Chapter 7:
M&A and Corporate Finance in the Luxury and Fashion Industry[1]

I. Introduction

This chapter describes the principal trends affecting corporate development strategies in the luxury and fashion industry, and looks at how they impact on the successful execution of mergers and acquisitions ("M&A") activity and corporate finance for companies in the industry. Unlike other chapters of this handbook, this chapter does not describe country-by-country approaches to M&A, as M&A by its nature is a much more global beast, with a marked level of consistency across borders in terms of structure and general mechanics.

II. The Trends behind Corporate Development Strategies in the Industry

Sales in the global luxury goods market have been characterized by impressive growth levels and an apparent resilience in the face of both the global economic downturn of 2008 and the Eurozone crisis of 2011 to 2012.[2] In the latest research by market intelligence firm Euromonitor International, sales are forecast to grow by a further 19 percent over the next five years, reaching US$405 billion.[3] The healthy appetite of consumers in this market, coupled with the vast opportunities now presented by emerging markets such as Asia and the Middle East, makes the luxury goods sector immensely attractive to investors.

The luxury goods M&A market has seen high levels of activity among a diverse range of players, including luxury conglomerates, financial institutions, family offices and emerging market buyers, which can be seen undertaking a range of different types of M&A transactions in order to pursue their strategic aims. Set against the backdrop of an increasingly globalized market, a persistent challenge that companies will face as they, in turn, also go global, is the volatility of the up-and-coming emerging markets. It is clear that expansion in these regions is becoming increasingly important to attaining growth. The proportion of the luxury market accounted for by emerging regions grew by 10 percent between 2008 and 2013 to reach 19 percent, and is forecast to grow a further 6 percent by 2025.[4] However, the nature of these markets means that setbacks are likely to continue to occur in the short to medium term. For example, the rapid growth of the luxury goods consumer base in China has recently been impeded by the government clampdown on corruption and the institution of new gift-giving regulations.

While individual corporate strategies will vary according to the individual company involved, the three key motivations in the luxury sphere are clear. They are: strengthening the product and

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[1] Tim Gee of the London office is the principal author. Mr. Gee gratefully acknowledges the assistance of Laurent Barbara, Stephane Davin, David Scott, Yasmin Joharchi, Edward Bibko, Ben Williams, Bernard Sharp and Lucinda Cavanagh.
[2] Euromonitor International, "The State of the Luxury Market', October 2013.
[3] Article on *Business Wire*, "Luxury Goods Sales to Reach US$ 405 Billion by 2019", 7 October 2014.
[4] Deloitte, "Global Powers of Luxury Goods 2014: In the hands of the consumer", 2014.

building the brand; equipping the business with the tools necessary to reach an ever-expanding consumer base; and competing in an increasingly consolidated market.

The acquisition of brands and the development of a portfolio – "horizontal integration" – is the classic type of transaction associated with luxury goods. It is a swift means of expanding a product brand, growing market share, cutting costs, and, in some cases, gaining better access to a particular geographic market. It is a strategy commonly pursued by the large luxury conglomerates. One example is LVMH's US$5.4 billion acquisition of Bulgari in 2011 – one of the largest deals to take place in the luxury goods sector over the past 10 years. The transaction enabled LVMH to strengthen its watch and jewelry brand. Kering, previously PPR, has also engaged in a number of horizontal M&A transactions over the past few years. In 2013, for example, it acquired an 81 percent stake in leading Italian jewelry brand Pomellato. Horizontal transactions not only strengthen the acquiring company but provide the target company with invaluable resources. This particular transaction enabled Pomellato to utilize Kering's expertise in distribution and spreading brand awareness and, most importantly, allowed Pomellato to become part of a global enterprise. This type of integration has even seen the consolidation of head-to-head competitors. Back in 2006, Adidas purchased Reebok for US$3.4 billion. While both companies were engaged in the production of sports apparel and equipment and competed against each other in this sector, the transaction enabled Adidas to achieve its strategic aim of strengthening its reputation in North America. These deals have also occurred among domestic companies in emerging markets such as Latin America. For example, in May 2013, Brazilian-based watch manufacturer Technos acquired its competitor Grupo Dumont Saab in a deal that totaled US$87 million, as part of its ongoing strategy to increase market share.

Another trend in the market is the execution of low-value acquisitions involving "distressed" yet established European brands by Asian buyers that have the capacity to inject capital and reinvigorate the business. This was the case with German fashion brand Escada, which declared itself insolvent in 2009 and was subsequently purchased by the Indian-based Mittal family – allowing Escada to post revenue growth two years later.[5]

For mature brands in the market, the acquisition of distribution channels at the one end, or of suppliers at the other, has become an important means of maintaining brand integrity and achieving higher margins. Securing greater control over the value chain allows a company to reinforce quality and branding across all stages. Armani's 2014 acquisition of its retail chain Armani Exchange is one such example of this. The acquisition of distribution and retail chains highlights Asia's key role in accessing consumers. United States-based fashion company Coach reacquired its retail operations across Asia, and in 2011 was able to list on the Hong Kong Stock Exchange. In February 2014, in a deal worth US$30 million, U.S.-based design house Kate Spade acquired its retail operations in Hong Kong, Macau, Taiwan, Malaysia, Singapore, Indonesia and Thailand. The businesses had previously been under the control of the Asian luxury good distributor Globalluxe.

The acquisition of the supply end of operations has recently become popular among the large luxury conglomerates, particularly those that wish to secure access to raw materials needed for specific products. In 2013, Kering acquired a majority stake in tannery France Croco –

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[5] Mergermarket in association with Michel Dyens & Co, "Buying into Luxury: A study on M&A activity in the luxury and premium consumer goods industry", 2012.

fundamental to the production of its leather goods. LVMH has completed a series of transactions, including the acquisition of its second tannery in May 2012, the purchase of a crocodile farm in 2013, and, most recently, the US$2.8 billion acquisition of an 80 percent stake in Loro Piana. Loro Piana had been a family-owned business since its founding in 1924, and this transaction is also representative of the changing dynamics involved in competing in the luxury goods market.

While vertical integration has become a common trend for brands that have already established a successful and stable position in the market, it is not the strategy pursued by young brands that wish to grow, or even by established brands that want to strengthen their presence on a global scale. For these companies, license and distribution agreements, joint ventures and local partnerships are still fundamental to pursuing their strategy. For example, Armani Exchange originally expanded through a joint venture between Armani and the Ongs' Como Holdings before Armani bought it back in 2014, and Coach and Kate Spade originally entered Asia via local distribution agreements.

The role of private equity players in nourishing the growth of young brands based in Europe and North America has come to the fore in recent years. Private equity has not traditionally been a key player, because many companies in the luxury market tend to be family owned and averse to the notion of outside control. However, this dynamic is changing. In December 2013, EMCap Partners and GenCap Advisory invested in the Italian shoe brand Moretti, with the aim of helping the company to expand in the Middle East, South East Asia and Russia. In addition, it is not only in the development of young brands that private equity firms are making investments, they are assisting with the expansion of existing and mature brands into new markets. One example of this is Blackstone's 20 percent investment in Versace in April 2014, to enhance both product lines and geographic reach.

L Capital's (LVMH's private equity arm) recent investments in cocktail bars, a delicatessen chain and a music label highlight another developing trend in luxury goods M&A – diversification to include luxury experiences.[6] This trend sees companies making investments in sectors outside luxury goods, which are nevertheless able to support and enhance the brand. According to a report by the Boston Consulting Group (BCG), 55 percent of luxury spending consists of experiential luxury and the sector has a 14 percent growth rate – 3 percent higher than that for luxury goods.[7] In May 2014, Chopard acquired Hotel de Vendome, from which originally it had rented space for a store. Over the past few years, LVMH has strategically been building its expertise in hospitality as part of its portfolio brand[8] – which now includes the luxury hotel chain Cheval Blanc, sponsorship of the Louis Vuitton Foundation in the Jardin d'Acclimatation amusement park in Paris and, after the 2011 acquisition, the Bulgari-Marriott joint venture chain of luxury hotels.

According to research by BCG, internet retailing, including both websites and multibrand websites, accounts for 17 percent of luxury sales in the U.S., and is growing at double the rate of the market as a whole.[9] In March 2014, U.S.-based jewelry-buyer Circa acquired Portero – a U.S. company that sells second-hand luxury goods online. E-commerce is also a vital tool for reaching consumers in emerging markets. In July 2010, LVMH acquired a 70 percent stake in Brazilian online perfume retailer Sack's. The deal allowed LVMH's product Sephora to compete in the

[6] Article in *The Financial Times*, "LVMH explores the layers below luxury", 10 September 2014.
[7] BCG, "Shock of the New Chic: Dealing with New Complexity in the Business of Luxury", 2014.
[8] Article in *The Financial Times* Material World Blog, "LVMH stealthily grows its hotel power", 5 August 2013.
[9] BCG, "Shock of the New Chic: Dealing with New Complexity in the Business of Luxury", 2014.

Brazilian market. In March 2012, Neiman Marcus acquired a 44 percent stake in Japan-based online retail company Glamour Sales Holding for US$28 million – a transaction that was key to the company's Asia strategy at the time. The company's decision to sell this stake earlier this year illustrates some of the difficulties associated with competing in emerging markets.

In today's luxury goods market, there are a number of strategic deal drivers behind M&A transactions. Companies require breadth across product lines, to maintain competitiveness, and also across geographies, to reach large and growing consumer bases. As well, they require depth across the value chain, in order to ensure that the quality of the brand permeates all stages. Experiential luxury and the growth of e-commerce have introduced new opportunities for companies to tap into a rapidly growing market. M&A activity in the luxury goods sector is now a matter of complex corporate strategy. Transactions need to be well planned, and carefully constructed and executed, in order to support a company's individual requirements.

III. M&A and other Growth Strategies in the Industry

A. Introduction

It is clear from the description of the trends in corporate development activity in the industry that deal structures employed to execute M&A and other growth strategies in the luxury and fashion industry are often more varied than in other industry sectors.

In addition to asset or sale deals, many growth strategies can only be accomplished at the necessary speed through licensing or franchising deals, or by participating with a local business in a joint venture. Equally, more mature brands are often looking to bring back control of such distribution channels to the brand owner, by buying out licensees or franchisees, or joint venture partners.

In this section, we look at the principal transaction types, joint ventures, licensing/franchising and M&A, and at some of the principal technical considerations relevant to each that are specific to the luxury and fashion industry.

B. Joint Ventures

A corporate alliance (a joint venture) may take many forms, from a purely contractual relationship to a jointly owned entity. It may involve transferring an existing business to the joint control of the parties, or indirectly acquiring an existing business from another party, in which case organizing the venture will involve elements of a disposition or acquisition, or both. Alternatively, an alliance may only involve license agreements, joint marketing agreements, affiliate revenue sharing agreements or other types of agreements in which the parties agree to pursue a set of common goals. Equity joint ventures occur when two partners participate through equity in a joint venture vehicle for the purpose of conducting business together in a particular jurisdiction (often an emerging market).

The following is a guide to where joint ventures fit among corporate transactions:

Outsourcing	***Corporate Alliances***			***Traditional M&A***		***Greenfield***
	(Non-Equity)	***(Equity)***				
Contract Services	Contractual Joint Ventures / \\ licensing, supply, distribution resource sharing	Non-Controlling Acquisition <50%	Equity Joint Venture	Controlling Acquisition >50%	Full Acquisition	Establishment of Wholly Owned Subsidiary

Among the reasons commonly cited for entering into a joint venture are:

- fast entry into local markets;
- low market entry costs;
- strong local player (e.g., established customer base, market presence, production capacity, complementary technology, employee base, distribution chain and political savvy);
- economical long-term resource commitment with shared risks; and
- diminished political risk (e.g., government interference, nationalization of wholly owned subsidiary) due to cost, local cultural resistance, foreign ownership restrictions and other factors.

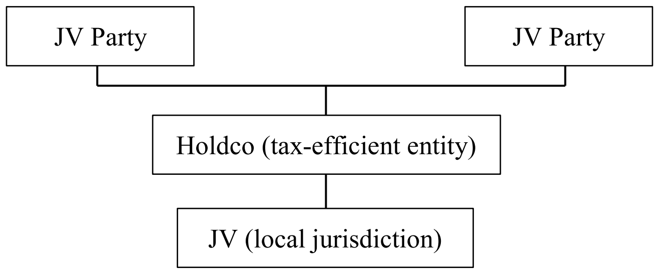
If a corporate joint venture is to be established, there are a number of business, legal and tax considerations that any prospective joint venture party should take into account. For tax efficiency, consideration should be given to the jurisdiction where the jointly owned entity should be organized. For example, it may well be beneficial from a tax perspective for the parties to form an entity outside the jurisdiction in which the joint venture is to operate (such as in a low-tax common law jurisdiction), which will then own the local joint venture operating entity. (A detailed discussion of tax planning strategies is outside the scope of this chapter, but please see Chapter 6 for some of the tax considerations specific to the luxury and fashion industry.)

Beyond tax considerations, there are legal considerations to be taken into account. In the luxury and fashion industry, from the brand owner's perspective, the joint venture vehicle should be organized, if possible, in a jurisdiction in which: there is a well-tested corporate law regime; specific performance is available as a remedy (this is particularly important with respect to enforcing provisions in the joint venture agreement on brand protection and also equity transfers); and the parties are able to live with the potential liabilities of the representatives who sit on the joint venture board.

Because these criteria will not be met in many developing countries, a prospective joint venture party should consider establishing a holding company in a well-established legal jurisdiction, utilizing a joint venture agreement governed by the laws of the jurisdiction in which the holding company is established, and operating the joint venture through a company that is wholly owned by the holding company.

A simple diagram of a holding company structure is:

Holding Company Structure



In addition to structuring issues, the principal issues to be considered in the context of a joint venture in the luxury and fashion industry are as follows:

- Ownership and control of the brand – typically, the brand owner will want to contribute only a license over the brand to the joint venture vehicle, and will want very tight control over brand positioning and quality.
- Exit – the brand owner will want the right to terminate any license and/or take reassignment of any brands whose ownership has been contributed to the joint venture vehicle. The brand owner may also want to control the distribution channel and pricing of any residual product inventory; and it may also be appropriate to impose non-compete restrictions on the other joint venture party to apply for a period after termination of the joint venture.

C. Licensing/Franchising

Licensing and franchising are other deal structures commonly adopted in the luxury and fashion industry.

1. Licensing

Parties may opt for a licensing structure where, e.g., the brand owner wishes to maintain ownership and control of the brand, but (for whatever reason) it desires to allow another party to exploit and develop the brand, either entirely or with reference to particular product lines, in a particular jurisdiction(s). This may come about because the brand owner wishes to grow the brand in a particular jurisdiction, but not directly, and not under a joint venture or franchising model, or it may alternatively see the jurisdiction as non-core to its own operating model, but is keeping the brand elsewhere and wants to continue to realize value from the brand in the non-core jurisdiction.

A licensing structure may also be forced upon the parties where the brand owner wishes to run certain product lines under the brand but allow a third party to exploit different business opportunities, and either the brand owner requires that it keep control of the brand or local law does not allow for "splitting" of the brand (where more than one party holds the rights to the brand trademark (usually covering different product lines/classes) in the same jurisdiction). Splitting is governed, in general, on a jurisdiction-by-jurisdiction basis; some jurisdictions allow splitting among classes, some allow splitting within classes, some do not allow splitting at all. In any event, splitting can be administratively difficult in many cases (e.g., product overlap is hard to avoid), which is often unappealing to parties. The key to whether splitting will work is to ensure that the mark is not diluted, and that there is no confusion in the marketplace.

Licensing can be structured in many different ways: perpetual or time limited; worldwide or as to particular jurisdictions; exclusive or non-exclusive; lump sum payment or royalties. etc. It can sometimes be less valuable to the brand owner as a transaction structure, as, while it confers rights on the licensee, it does not convey ownership in the underlying intellectual property (IP). However, as a counterproposal to this, as well as considering a more traditional M&A structure (as will be discussed later in this chapter), the brand owner could consider selling the brand and taking a license-back for the business that it wishes to retain.

License agreements carefully prescribe what licensees can and cannot do with the brand, to define a precise scope for the licensee to operate within, to preserve the integrity of the brand for the brand owner, and to ensure a consistent positioning of the brand in the market. They are typically very licensor-friendly and not open to much negotiation.

2. Franchising

Franchising is another transaction structure, and one that, indeed, relies heavily on licensing. Under this model, the brand owner generally will roll out its already successful business model into new jurisdictions/areas, licensing rights to third-party franchisees to run the business in such new jurisdictions/areas, subject to a narrowly defined operating scope. As with pure licensing, the franchise may be limited or unlimited by time (although it is usually limited), exclusive or non-exclusive, and it will cover particular jurisdictions/areas. It will usually be subject to a royalty arrangement (for use of the brand IP), a service fee (for services provided by the brand owner – e.g., finance, human resources, advertising, marketing, training), and an annual or quarterly percentage of turnover payment (the franchise fee), and so, the success of the franchisor under the arrangement will depend, to a large extent, on the success of the franchisee.

Franchising arrangements are often used to allow brand owners to more fully exploit their brand, but without increasing their responsibility or liability, and avoiding a rollout of chain stores, etc. Essentially, the brand owner licenses the rights to use its IP and business model, and distribute its products, in return for a fee.

As with license agreements, franchise agreements set out very detailed provisions governing what the franchisee can and cannot do in respect of the brand and business.

Some countries explicitly regulate franchising (e.g., the U.S.); others do not, but have multiple laws that impact on the model (e.g., the United Kingdom).

Example of well-known franchises (to differing extents) in the luxury and fashion industry are Armani, Burberry and Dolce & Gabbana. Equally, other brands, such as Louis Vuitton, are believed to continue to favor a directly operated stores ("DOS") model. In addition, in recent years, the industry has, in some jurisdictions (e.g., Russia), seen a move away from franchising, with companies reverting back to DOS, although this can be due to business-specific, as well as jurisdiction-specific, trends.

D. M&A

1. Introduction

Businesses that may be M&A targets are commonly held in privately owned companies or in publicly traded companies. The rules and timetable for acquiring privately held businesses are generally a matter of private negotiation between the buyer and the seller. Most of the processes by which these transactions are carried out, and the terms on which those transactions tend to be executed, are not particular to the luxury and fashion industry, and therefore this chapter will not review these. However, there are some areas where there are specific considerations to be taken into account in transactions involving the luxury and fashion industry, and these are described below.

In particular, we will look at:

- merger control;
- due diligence; and
- price adjustment.

When it comes to acquisitions of publicly traded companies, there are specific mandatory rules and timetables that apply to the acquisition of control of such entities, and these vary depending on which country the target company is incorporated and/or resident in. It is beyond the scope of this chapter to review these different country regimes, as they are typically complex, as well as being highly regulated, and any such transaction needs to be the subject of specific legal advice. Furthermore, there is little in a public company acquisition that is specific to the luxury and fashion industry. In particular, due diligence will always be limited in a public company acquisition, and price adjustments are not generally permitted, so the particular factors described below in relation to private company acquisitions will not be relevant.

2. Merger Control

Because few M&A transactions in the luxury and fashion industry involve material concentrations of market share, it is often thought that merger control restrictions are of little significance. In fact, they are of very material significance when it comes to the timing of completing such transactions. This is because companies with high-value brands often have sales into many countries around the world, and the volume of sales into a particular country that will trigger a merger control filing requirement is sometimes very low. As a result, many transactions in the luxury and fashion industry require a detailed merger control filing analysis across multiple markets and may trigger multiple individual filing obligations. The merger control rules of many countries, including, in particular, China, are suspensory in effect, which means that a transaction may not be completed until the relevant approval has been obtained. Some of these approval processes are very lengthy, extending up to a number of months.

3. Due Diligence

Due diligence can involve varying levels of review – from a very cursory review of major issues and limited documents, to a very detailed review and summary of all issues and documents likely to impact the risk and pricing profile of a target and, ultimately, the integration of the newly acquired business. In determining where a buyer falls on this continuum, there is often a tension at play (particularly in an auction context) between implementing a "quick pass" over the relevant documents in a data room, looking for red flags or deal-stoppers, so as to not expend too many resources too early in the process (i.e., before being selected as the successful bidder), and conducting a meaningful review of all relevant risk areas and available documents in order to validate the pricing model and form a post-closing integration plan.

Within the luxury and fashion industry, when deciding the scope of the due diligence review, there are a number of areas where it may be advisable to pay particular attention. These include real estate, IP, the supply chain, and privacy/data protection.

a. Real Estate

While not often significant in other M&A transactions, real estate can be crucial to a luxury brand's success. Success in luxury goods often hinges on the quality of the retain portfolio and, in particular, of flagship stores within major cities. Particular attention, therefore, must be paid to any restrictions contained within change of control or assignment clauses within leases, to ensure that the leases will remain in place post-completion.

b. IP

For luxury brands, IP is the foundation on which the success of the business is built. Protection of IP is paramount to the growth of brand value, and it is crucial that the due diligence report covers whether or not the target company has managed its trademark portfolio well and whether or not there has any infringement of the company's IP rights.

The transfer and assignment of IP rights and related licenses is regulated in many countries by technology transfer or similar legislation. Approvals and notices to appropriate authorities may be necessary. It is also often found that IP rights are owned by a parent or related company not being sold, in which case assignments of those rights will have to be separately obtained. Again, sufficient time must be allowed for these assignments, and transitional arrangements may be necessary. Furthermore, searches may reveal registrations in the name of predecessor companies or previous owners. In many jurisdictions, changing the registrations is a slow procedure, and recent sale transactions may not yet be reflected in the registry. This should not present an insurmountable problem, but it can be cumbersome in that the buyer will require assurances of the chain of title from the registered owner to the seller.

c. Supply Chain

Increasingly for buyers in the luxury and fashion industry, a key consideration in due diligence is the compliance profile of the target. This is not confined to issues of bribery and corruption. Rather, it extends to every way in which the target business has been run, including its approach to managing risk in its tax affairs, its treatment of employees, it health and safety record, its environmental record and the quality of its internal controls.

Specifically, acquirers now look beyond the immediate target and also investigate its supply chain to look at its compliance record. The negative brand impact of failings in the way a company does business (including through its non-owned supply chain) are potentially enormous, and can dwarf some of the other areas of due diligence typically considered as relevant to value.

d. Privacy/Data Protection

Increasingly, management of customer data is central to marketing strategies for businesses in the luxury and fashion industry. However, privacy laws are now in force in many countries around the world. These laws vary from country to country, although are generally applied to prevent or restrict the disclosure of personal information about individuals, and their effect may be triggered if the seller, the confidential information in question or the buyer is located in any such country where those laws are in force. In addition, the laws of some countries are extraterritorial in effect and inconsistent with those of other countries.

Accordingly, before any seller discloses any personally identifiable information, it will need to ensure that the contemplated disclosure does not violate any applicable data protection or privacy law, or any privacy policy or representation that the seller has made to the relevant individuals with respect to the protection of that information. From the buyer's prospective, any future use and disclosure of that information must be carefully monitored.

4. Purchase Price Adjustment Mechanisms

Purchase price adjustment mechanisms are (generally) pro-buyer provisions in a sales and purchase agreement ("SPA"), which (after closing) seek to adjust the purchase price for the business paid at closing by reference to whether or not accounts drawn up at closing show a shortfall against certain target numbers – typically, working capital, net debt and, sometimes, net assets.

Where there is competition for an asset, a seller may be in a strong enough position to propose that the sale be conducted on a different basis, which is (generally) more pro-seller. This is the so-called "locked box" method. In a locked box sale, potential buyers have the opportunity to diligence a set of recent accounts; the purchase price is then set by reference to those accounts, and the buyer takes the risk or profits of losses in the business since the date of those accounts. The buyer's position is protected by undertakings to run the business in the ordinary course of business from the accounts date to the closing date, and by an undertaking not to take dividends or other distributions out of the business after the accounts date. The effect of this is that there is no post-closing adjustment to the purchase price. The purchase price is set before signing but does not change, and the business and its results are put in a "box". The mechanism is much favored by private equity sellers, who are attracted by the certainty as to the final sale proceeds that it produces. It allows a private equity seller to distribute proceeds immediately following a closing to its Limited Partners, rather than having to wait until accounts have been drawn up and the numbers agreed post-closing. The quicker the return of capital the private equity seller can make to its LPs, the greater the internal rate of return (IRR).

In the context of the luxury and fashion industry, a number of factors specific to the industry need to be taken into account in understanding the implications of these two approaches.

First, while seasonality is not exclusively an issue in the luxury and fashion industry, the fashion part of the industry is peculiarly sensitive to seasonal performance. This impacts inventory value and, thus, working capital. It is essential, therefore, in any post-closing purchase price adjustment mechanism, that the target working capital is normalized for the point in the year at which closing is anticipated to occur, and that there is detailed agreement on the principles under which inventory and, importantly, its potential obsolescence, will be valued.

One way in which, in other industries, parties to a sale try to agree the inventory valuation issue is to allow a seller (who is unhappy with the buyer's proposed approach to obsolescence in the closing accounts) to purchase the relevant inventory at the value ascribed by the buyer, so that the seller is free to sell it as best it can. In that way, the seller "puts its money where its mouth is". In the luxury and fashion industry, however, the pricing and distribution channel policies adopted in respect of selling off old stock can have a hugely negative impact on the current season, and on the overall brand positioning. It is more usual, therefore, for buyer and seller simply to have to seek agreement on the valuation principles.

Equally, volatility in business performance can create risks in a locked box mechanism. Normally, the buyer and seller in a locked box deal will agree what is effectively an "interest rate" for the anticipated value of the buyer acquiring the profit from the business from the accounts date onwards. In other words, a notional return rate will be payable on the purchase price for the period between when it is set (at signing) and when it is paid (at closing). In an environment of non-stable earnings, this can be a significant risk for the buyer.

Another area of concern that is particularly relevant to the luxury and fashion industry is where there is a leasehold portfolio that is material to the business. In many cases, landlords will have a right to terminate a lease upon a change of control in the tenant (and, sometimes, in the tenant's ultimate parent). Where this creates material risk for the buyer, it may seek a gap between signing and closing to enable the parties to approach landlords for their consent to the transaction. The question then arises as to how the results of that consent process will affect the purchase price, if at all. The most commonly used valuation methodology for setting a purchase price is by reference to a multiple of earnings before interest, taxes, depreciation and amortization ("EBITDA"). However, where a luxury or fashion business's retail portfolio is material to its business, the impact on brand value of losing a particular store is not necessarily measured most appropriately by reference to that store's individual EBITDA contribution. Most obviously, the loss of value from losing a flagship store usually does not correlate with the loss of EBITDA from that store, so careful thought will need to be given to the individual drivers of value in a target business.

IV. Acquisition Finance in the Luxury and Fashion Industry

A. Introduction

One of the key issues for any buyer making an acquisition is how to fund it. In this section, we will look at the most common forms of financing available to a buyer, and then focus on some of the specific legal and due diligence issues that may need to be considered when an acquisition is made in the luxury goods sector.

B. Financing an Acquisition

There are generally three main ways of financing an acquisition – by way of cash, equity or vendor finance. Cash will typically be sourced from a buyer's share capital, its retained profits, a loan facility or a capital markets instrument. Equity finance might consist of a share for share offer (i.e., an issue of shares in the purchaser in return for the shares in the target) and vendor finance could come from either vendor debt, deferred consideration or earn-out clauses.

Assuming a buyer wants to fund the acquisition by way of cash, it may find that it is unable to do this with just its own existing cash reserves. If this is the case, two of the most common funding options would be to raise cash by way of either a bank loan or the issuing of debt securities (notes/bonds), or by a combination of the two.

"Leveraged finance" will often play an important role in an acquisition, particularly where private equity is involved. Here, companies are acquired, generally by private equity funds or hedge funds, pension funds or sovereign funds, using large proportions of debt (and therefore less equity) to finance the acquisition. The use of debt increases the financial return (yield) to the private equity sponsor if the investment goes well, but also increases the risk if it does not. This is based on the theory that the return on an investment, all being equal, is unaffected by the financing structure used to acquire that investment.

Senior debt will typically form a core part of any funding used by the buyer in a leveraged finance acquisition. This is because it increases the potential yield and has historically been the cheapest and most readily available source of debt available to a sponsor. Senior debt packages typically contain one or more medium-term acquisition loans, with maturities of between five and eight years. These loans are often made available to a special purpose vehicle set up to make the acquisition (Newco).

Use of debt finance to fund an acquisition may have significant tax benefits.

In addition to acquisition term loans, the target business may have a need for working capital or capital expenditure facilities to help support the growth of its brand. These can often be provided at the same time as an acquisition facility (although the use and need for such a facility will depend on the target business in question). It is also becoming increasingly commonplace to see additional acquisition (and capital expenditure) finance facilities made available to a sponsor to allow for further acquisitions using the existing group as a platform for such acquisitions.

Ultimately, any choice of funding will depend on a mixture of commercial, financial and legal factors. Businesses in the luxury and fashion industry have clearly shown that they are prepared to turn to different sources depending on their size and the phase of their growth. As will be described in Section V of this chapter, established brands have been seen to call on the public markets through initial public offerings (IPOs) (e.g., Michael Kors and Prada), while, at the same time, smaller brands have been benefiting from intense private equity interest. One of the key advantages of debt financing over equity financing is the relative stability of the debt markets and, therefore, the likely availability of financing at a time that suits the borrower.

C. Structuring an Acquisition

There is no one-size-fits-all model for acquisition structures, as there are often numerous factors to consider. Common considerations include:

- will there be an asset purchase or a share purchase;
- where are taxable profits or losses located;
- what are the main geographical regions of activity (e.g., where divisions are acquired in different regions, it is not uncommon for each division to borrow separately so as to take advantage of local tax deductions);
- is there a level within the group at which certain lenders or banks should have no restrictions or controls; and
- are there any specific requirements for the seller?

In leveraged finance, new standalone loan facilities are entered into to fund a large proportion of an acquisition. Here, it is common to see a series of Newco entities established as vehicles for the acquisition. This may facilitate post-acquisition restructuring or future business strategies, and can also be important for tax optimization, and improving the quality of the credit by reducing or removing the need for local-law-based restrictions on upstream guarantees.

D. Lenders' Key Legal Due Diligence Issues

Brand is key in the luxury and fashion industry, and a careful review of a business's IP will usually be essential to any acquisition process. Lenders will typically want reliance rights on the borrower's due diligence (or, in the U.S., to have their own due diligence done) to confirm that the business not only has title to its most important assets but also that appropriate protections and filings are in place and up to date. A lender will, therefore, often insist on a review of all IP (e.g., patents or trademarks, design rights and domain names) and that security be granted over these rights. The time and cost of these reviews (and then rectifying any anomalies that they may bring to light) should not be underestimated and will form an important part of any transaction.

A lender will also want its legal due diligence to review the business in general and to bring to light any issues or liabilities that could affect the brand in the future. It would not be unusual for a lender to, therefore, review a target's material contracts, its title to assets (e.g., flagship store leases, plant and equipment, as well as IP), its health and safety plans, its environmental policies, its ongoing litigation or its pension commitments.

Increasingly for lenders in the luxury and fashion industry, there is emphasis not just on title to assets and access to cash flows (the traditional security for lenders) but also on compliance in its widest sense. The negative brand impact of failings in the way a company does business round the world (including through its non-owned supply chain) can be an even greater risk for a lender than whether its security interests are perfect.

V. Equity Capital Financing in the Industry

A. Introduction

The equity markets are more volatile than the debt markets, and the timing of an IPO or secondary issue is often something outside the control of the issuer. Notwithstanding this, luxury and fashion industry companies are increasingly pursuing IPOs for a number of reasons. In addition to raising capital to fund growth, IPOs create freely tradable shares than can be used as acquisition currency. IPOs can also help enhance brands, solve family succession issues and provide an exit for private equity and other investors.

Below is a short discussion of some of the main considerations to be taken into account by any company in the industry seeking to go public.

B. Where Should I List?

The flow of capital has become truly global, and an issuer should have access to most of the same international investors, whether it lists in London, New York, Hong Kong or on any of the other major exchanges. So, how to choose? It comes down to a simple cost-benefit analysis considering potential valuation and compliance obligations. Depending on the issuer's strategy, products and sales markets, it may find that analysts focused on a particular exchange will recommend higher valuations than in the other markets. On the other hand, certain exchanges are subject to more onerous regulatory regimes. Hong Kong is a good example. Some luxury goods manufacturers found that Asian analysts were prepared to give high valuations, especially if the issuer's growth story focused on growth in the Chinese market. However, as Alibaba found out, Hong Kong is a difficult listing, which routinely takes more than a year to complete, as compared with an average timeline of four to five months for London and New York.

C. Am I Ready to List?

Financials are the first consideration. Most exchanges will require an issuer to have at least three years of audited financial statements, and additional information may be necessary – e.g., if there have been significant changes to the business during that period. In addition, the IPO process will consider whether the issuer is ready to be a public company and to publish accurate financial statements on a timely basis. Typically, the issuer's auditors will prepare a "financial reporting readiness report", identifying matters such as weaknesses in a company's financial reporting system. If nothing else, the company should talk to its auditors about readiness well in advance of the IPO.

As part of the IPO, legal counsel would conduct a thorough due diligence review of all of the issuer's material contracts. Ideally, issuers should start gathering relevant materials and consider doing an initial internal review to uncover and correct any issues before the IPO kick-off. Common issues include perfecting title to material assets, resolving issues with key licenses, regulatory non-compliance, wrapping up major litigation, and obtaining required third-party consents (including with respect to a change in ownership).

D. What Structural Changes will be Required?

Before starting an IPO, issuers should consider their tax structure. The goal is to minimize corporate income tax, as well as the tax implications for exiting shareholders (e.g., capital gains) and for new investors (e.g., withholding taxes on dividends). To do this, companies often add a new top holding company (as the company to be listed) in a tax-neutral jurisdiction such as Jersey or the Cayman Islands.

Issuers will need to consider a number of shareholder issues. First, London and other major exchanges require the placement of a minimum percentage of the issuer's total shares (25 percent in the case of London) to ensure that there will be adequate trading liquidity after the IPO. Major shareholders often need to enter into relationship agreements with the issuer, under which they agree that all future dealings with the company will be on an arm's-length basis. Founders will usually be expected to sign non-compete agreements. Existing shareholder agreements are generally terminated upon IPO and all major shareholders will agree to have their shares "locked up" for six months or more following the IPO.

The issuer will usually need to strengthen its corporate governance prior to an IPO. Rules differ, but companies strive to implement the highest standards they are capable of because this can directly impact investor interest and their valuation. Best practices include having the role of CEO and board chairman split, to have a majority of independent non-executive directors on the board and on the audit and compensation committees.

E. Can I Talk about Our Plans?

Although typically not an issue well in advance of a transaction, publicity restrictions will be required to be put in place prior to starting an IPO. Under these restrictions, no public statements should be made about the IPO, and the issuer should not deviate from its normal course of public communications, without first consulting counsel. In most cases, lawyers can find a way for issuers to achieve what they want to do. Managing publicity can be a special challenge for companies in the luxury and fashion industry with a large public following, especially if they use social media to engage with their customers. Violation of the publicity restrictions can have severe consequences, including a postponement of the transaction.

F. Conclusion

A successful IPO is a tremendous achievement in the life of a company. It is also a very demanding transaction, with management being pulled in many directions by the deal team while running the business at the same time. It is an event for which long-term planning is required. While it can significantly enhance brand projection and access to expansion capital, it is likely to involve a material change to the ethos of the business in the way in which management control is exercised. That change process is sometimes painful but, properly executed, provides an opportunity for dynamic growth and a long-term, sustainable corporate platform for the brand.

Chapter 8: Anti-bribery and Other Compliance Issues and Risk Remediation for the Luxury and Fashion Industry[1]

I. Introduction: Overview of the Issues Facing the Luxury and Fashion Industry

The luxury and fashion industry has historically not been viewed as an industry at high risk for public corruption. This is mainly because it does not depend on government contracts, which traditionally have been the subject of Foreign Corrupt Practices Act (FCPA) enforcement. However, recent FCPA cases demonstrate the focus of United States law enforcement authorities on corruption in more mundane government interactions, including in connection with regulatory compliance, audits, permits and customs clearance. Consumer goods companies, including luxury and fashion companies, are no longer immune from the scrutiny of the U.S. government for FCPA violations. Other countries have also started to adopt tougher anti-corruption laws and have begun to enforce them more aggressively. As sales of luxury goods in emerging markets, such as China, India, Brazil and Russia, that are also prone to corruption continue to grow, the luxury and fashion industry must take proactive measures to better protect itself from corruption risks.

This chapter will cover the fundamentals of anti-corruption legislation and relevant developments in the U.S. and globally, highlight specific risks applicable to the industry, provide guidance on the requirements of a compliance program and discuss recent international developments.

II. Recap of the FCPA

The FCPA was enacted in 1977, in the wake of reports that many U.S. businesses were making large payments to foreign officials to secure business. The act has two provisions: (1) a prohibition on bribery of foreign officials, political parties or candidates for public office for the purpose of obtaining or retaining business; and (2) a requirement that companies with registered securities and companies required to file periodic reports with the Securities and Exchange Commission (SEC) establish and maintain accurate books and records and sufficient internal controls. The following section explains the key provisions of the FCPA and the penalties for a violation.

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[1] Lina Braude, a partner in the Compliance and Investigations Practice Group, based in the Washington DC office, is the principal editor and contributing author of this chapter. Ms. Braude gratefully acknowledges the assistance of Tom Firestone, Jane Klinger, Trevor McFadden, Jean-Paul Theroux, Crystal Jezierski and Erica Spencer of the Compliance and Investigations Practice Group, based in the Washington DC Office. The country-specific sections of Part IV were prepared by Jonathan Nelms and Anton Subbot, Washington DC and Moscow; Geoff Martin, Washington DC; Aurelio Giovannelli, Francesca Baratta and Roberto Cursano, Rome; Eric Lasry and Sara Koski, Paris; Esther Flesch, Muriel Sotero and Erica Sellin Sarubbi, Sao Paulo; Jesse Heath, Mexico City; Mini vandePol, Peter Andres and Naomita Royan, Hong Kong and Washington DC; Michelle Gon and Vivian Wu, Shanghai.

1. Introduction

Although the FCPA has been somewhat controversial in the American business community, it is clear that it is here to stay. Over the past several years, enforcement activities on the part of the U.S. Department of Justice (DOJ) and SEC under the FCPA have only increased, with a greater emphasis now on individual prosecutions. At the same time, large FCPA fines have continued to be imposed. DOJ and SEC articulated an expansive view of FCPA jurisdiction in the 2012 *Resource Guide to the US Foreign Corrupt Practices Act* (the guidance).[2]

2. Anti-bribery Provisions of the FCPA

a. Introduction

The anti-bribery provisions of the FCPA prohibit any person (including in the case of a company, its officers, directors, employees, agents and stockholders acting on its behalf), from corruptly making an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift or promise to give, or authorization of the giving of anything of value to:

i. any foreign official, political party, or candidate for foreign public office for purposes of
   - (a) (i) influencing any act or decision of such foreign official in his official capacity, (ii) inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official, or (iii) securing any improper advantage; or
   - (b) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such [entity] in obtaining or retaining business for or with, or directing business to, any person; . . .15 USC § 78dd-1(a)

b. Elements

There are six elements of a violation of the anti-bribery provisions of the FCPA:

i. "*Issuers*," "*Domestic Concerns,*" and "*Persons Other Than Issuers or Domestic Concerns*" (Other Persons). The FCPA prohibits the making of improper payments by all persons engaged in international business; however, the precise application of the law depends on the status of the actor as an "Issuer," "Domestic Concern" or "Other Person." Issuers include public companies (whether U.S. or foreign) registered pursuant to Section 12 of the Securities Exchange Act of 1934 (the Exchange Act) and companies required to file reports with SEC under Section 15 of the Exchange Act. Domestic Concerns include U.S. corporations, partnerships or other business entities that are organized or have their principal place of business in the U.S., as well as individuals who are citizens, nationals or residents of the U.S. Other Persons include all non-US persons not otherwise covered: e.g., foreign citizens and corporations. The guidance takes the aggressive position that Issuers (U.S. or foreign), and their officers, directors, employees, agents and stockholders, may subject themselves to FCPA jurisdiction based on *de minimus* contacts with the U.S., such as a telephone call, email, text message or fax to or through the U.S., as well as a

[2] *FCPA: A Resource Guide to the U.S. Foreign Corrupt Practice Act* (2012), published by the Criminal Division of the U.S. Department of Justice and the Enforcement Division of the U.S. Securities and Exchange Commission.

wire transfer from or to a U.S. bank, or otherwise using the U.S. banking system, or traveling across a state border or internationally to or from the U.S.

The guidance further clarifies that the FCPA covers any person or entity that engages in any act in furtherance of a corrupt payment while in the territory of the U.S., regardless of whether they use the U.S. mail or a means or instrumentality of interstate commerce. It also states that a foreign national or company may be liable if it aids or abets, conspires with, or acts as an agent of, an issuer or domestic concern, regardless of whether the foreign national or company itself takes any action in the U.S.

In addition, the FCPA applies not only to the entity itself, but to any officer, director, employee or agent of the entity, and any stockholder acting on behalf of the entity. Finally, if a U.S. company controls a foreign entity and has actual or constructive knowledge of that entity's improper actions, the U.S. company may be considered to be a participant in those actions and therefore subject to prosecution.

ii. *Corrupt Intent.* The person making or authorizing the payment must have done so with corrupt intent. This means that the payment must be intended to cause the recipient to misuse his or her official position in order to wrongfully direct business to the payor or the payor's client or to secure an improper business advantage. Thus, "corruptly" connotes an evil motive or intent to wrongfully influence the recipient. One key indication of such corrupt intent is an attempt to conceal the payment or the relationship between the payor and the recipient.

In order for a defendant to be criminally liable under the FCPA, he or she must act willfully. Although this term is not defined in the FCPA, DOJ and SEC explain that it requires a defendant to know that he or she is committing an act for a "bad purpose." The guidance cites decisions from the U.S. Courts of Appeals for the Second and Fifth Circuits to support the proposition that it is not necessary in order to establish willfulness that the government prove the defendant is either aware of the FCPA or specifically knows that he or she is violating the FCPA.

iii. *Payment/Offer of Payment.* The FCPA prohibits paying, offering, promising to pay, or authorizing another to pay or offer, money or anything of value, even if no actual payment is made. The guidance makes clear that the corrupt act does not have to succeed. The bribe payor may still be liable if the foreign official does not actually accept or receive the corrupt payment. As long as an offer, promise or authorization for a corrupt payment is made, the actor does not even need to know the identity of the recipient. An attempt is sufficient to establish liability. Thus, if an executive authorizes a payment by saying "pay whomever you need to" in order to obtain a government contract, a violation occurs even if no bribe is paid.

iv. *Foreign Official, Political Party or Candidate.* A "foreign official" is any officer or employee of any department, agency or instrumentality of a foreign government, any person acting on behalf of a foreign government, or any official of a public international organization (e.g., the International Monetary Fund).[3] "Instrumentality" is not defined, and the term is particularly ambiguous when applied in transitional economies where many entities have some degree of government ownership or control. DOJ has taken the position that *any* government ownership of an entity in the process of privatization may lead to the conclusion that it is an

[3] The act refers to a list of such organizations designated by executive order of the President and codified at 22 USC § 288. Several additional examples of such public international organizations are: the European Bank for Reconstruction and Development, the International Bank for Reconstruction and Development, the OECD, the United Nations and the World Trade Organization.

instrumentality of the government, but this position has not been fully tested in court. An alternative interpretation is that active governmental control is the crucial issue, and thus equity ownership is only one indication of whether a particular entity can be considered a government instrumentality. The Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention) and the commentaries thereto take this less stringent view of the degree of government influence over a company's activities necessary to trigger enforcement. Such interpretation, however, is not binding on U.S. authorities.

The guidance generally restates the positions that the government has taken in various proceedings as to the FCPA's definition of "foreign official," as well as to the application of that definition to foreign government "instrumentalities," such as state-owned or state-controlled entities. The guidance underscores the inclusion of "low-ranking employees and high-level officials alike" in the definition and points out that the FCPA prohibits payments to foreign *officials* (i.e., individuals) rather than foreign *governments*. The guidance then goes on to describe, in some detail, the government's position on the ownership and/or operational attributes that qualify an entity as an "instrumentality" of a foreign government.

The "instrumentality" analysis, according to DOJ and SEC, is premised on a fact-specific evaluation of "an entity's *ownership, control, status, and function*." Referencing recent court opinions, the guidance cites factors such as "degree of control," "level of financial support by the foreign state" and the "entity's provision of services to the jurisdiction's residents" as specific considerations that companies must consider when determining whether the foreign entities they are conducting business with create heightened FCPA risk as government "instrumentalities." More intriguing, perhaps, is the government's assertion in the guidance that, although no single factor is dispositive of an entity's classification as a government "instrumentality," an entity is unlikely to qualify as an "instrumentality" when the foreign government's ownership interest in the entity is less than 50 percent. The principal exception to this general rule, however, is where the foreign government, while perhaps only holding a minority ownership stake in the entity, maintains veto power and/or control over important operational decisions.

v. *Business Purpose.* The FCPA prohibits payments made to assist an individual or entity in obtaining or retaining business for or with, or directing business to, any person. The business to be obtained or retained does not need to be with a foreign government or foreign government instrumentality. This provision has been construed very broadly to include, for example, payments made to obtain favorable tax treatment or to obtain a permit or other government approval. In 1998, a set of amendments (the 1998 amendments) modified the FCPA to comply with the OECD Convention, by providing that a payment made to a foreign official for the purpose of "securing any improper advantage" in obtaining or retaining business is a violation of the law. The use of this phrase to describe the purpose of the payment, rather than the result of the payment, may cause confusion.[4] Given the historic breadth of interpretation of the earlier FCPA terminology,

[4] OECD Convention prohibits payments made "to obtain or retain business or other improper advantage . . . ." Under this construction, it is clear that payments made to secure any improper advantage, even if not directly related to obtaining or retaining business, are prohibited. The 1998 amendments, by contrast, added the phrase in such a way that "securing any improper advantage" must result in obtaining or retaining business. In the current FCPA, covered persons are forbidden to make payments to "influence" a foreign official to act or omit to act, to "induce" a foreign official to violate an official duty, or to "secure" any improper advantage, in order to obtain or retain business. It would, therefore, appear that the scope of the FCPA prohibition is more narrow than that of the OECD Convention.

however, the placement of the "securing any improper advantage" language makes little difference, as nearly all such payments can be linked in broad terms to obtaining or retaining business.

vi. *Interstate Commerce.* As a result of the 1998 amendments, the FCPA now imposes different jurisdictional requirements on Issuers and Domestic Concerns, on the one hand, and "Other Persons," on the other. Other Persons are subject to U.S. jurisdiction when they take some act in furtherance of an improper payment while physically present in the territory of the U.S., regardless of whether or not they use some instrumentality of interstate commerce. U.S. entities and persons are subject to prosecution for their improper acts *outside* the territory of the U.S., with no use of an instrumentality of interstate commerce, under the nationality basis of jurisdiction; however, U.S. entities and persons who commit an improper act *within* the U.S. must have some connection with an instrumentality of interstate commerce. Interstate commerce is a very broad concept that includes trade, commerce, transportation, or communication among states or between any state and a foreign country. Thus, a telephone call or wire transfer of funds is an act in interstate commerce. The dual regime represents a substantial expansion by the 1998 amendments of the jurisdictional basis for FCPA enforcement actions.

c. Agents and Other Intermediaries

The FCPA also prohibits corrupt payments made through agents or other intermediaries. Thus, it is unlawful to make a payment to any person, while knowing that all or a portion of the payment will be offered, given or promised, directly or indirectly, to any foreign official, or foreign political party, candidate or official, for any of the prohibited purposes discussed above.

The term "knowing" includes conscious disregard, deliberate ignorance and willful blindness. The legislative history of the FCPA explains that "the so-called 'head in the sand' problem . . . should be covered so that management officials could not take refuge from the statute's prohibitions by their unwarranted obliviousness to any action (or inaction), language, or other 'signaling device' that should reasonably alert them to the 'high probability' of an FCPA violation."[5] The elements of an offense involving an agent or intermediary are essentially the same as described above, except that, in this circumstance, the "recipient" is the intermediary who is making the prohibited payment. Of course, for there to be a violation of the FCPA, it would have to be proven that a payment, or an offer to make a payment, was made to a foreign official.

Although it acknowledges the frequent business necessity of engaging third parties in foreign countries, the guidance cautions about the risks involved in engaging third parties. To emphasize that use of third-party intermediaries will not insulate a company from liability, the guidance cites several recent corporate resolutions involving different types of third-party arrangements that resulted in significant monetary penalties. Included in the litany of enforcement actions involving third parties, with total sanctions of approximately US$2 billion, are cases involving agents of a joint venture in the Nigerian "Bonny Island" matter, a distributor of AGA Medical, an agent of Innospec in Iraq, and Panalpina, a Swiss company acting as a freight forwarder in a matter in which its U.S. subsidiary acted as an "agent" of several U.S. issuers and was charged directly with violating the FCPA.

[5] H.R. Conf. Rep. No. 576, 100th Cong., 2d Sess (1988), 919-21.

The guidance emphasizes the requisite level of knowledge to find liability for the acts of third parties. In laying out the applicable "knowledge" standard, the guidance tracks the statute and its legislative history, making clear that liability may derive from either actual knowledge of wrongdoing or purposeful avoidance of actual knowledge. The guidance points out that an important aspect of any knowledge analysis involves red flags that, if consciously avoided, can provide the basis for imputing knowledge. To this end, the guidance identifies a number of red flags commonly associated with third parties that generally relate to potential concerns with payment terms, scope of services, and government official relationships.

Notably, however, in discussing the FCPA's "knowledge" standard in this section of the guidance, DOJ and SEC omit any reference in the text to a recent influential U.S. Supreme Court opinion that addresses the scope of the criminal "willful blindness" doctrine. In that case, *Global-Tech Appliances, Inc. v. SEB S.A.*, the Supreme Court held that, in order for "willful blindness" to apply, the defendant must (1) subjectively believe that there is a high probability that a fact exists; *and* (2) take deliberate actions to avoid learning of that fact.[6] The *Global-Tech* court's guidance on "willful blindness," although dicta, clarifies the scope of the doctrine and thus has important implications for FCPA matters involving the question of "deliberate indifference." In the FCPA context, the Second Circuit in *United States v. Kozeny* reaffirmed the government's longstanding position that an individual may be liable for a bribery offense absent actual knowledge if there was a "high probability" that the individual was aware of bribes being paid but "consciously and intentionally avoided confirming the fact."[7] In recent years, several FCPA enforcement actions have also underscored that deliberate ignorance of improper payments will not shield an individual or company from FCPA liability.[8]

d. Parent-Subsidiary Liability

The SEC appears to have taken the position that a parent company can be liable for its subsidiary's actions even if the parent had no knowledge of the wrongdoing or any inappropriate amount of control over the subsidiary. Even more troubling is the recent settlement of an FCPA enforcement action against the Ralph Lauren Corporation, in which DOJ has now apparently adopted SEC's expansive view of parent corporation liability. The agencies' basic view is reflected in the guidance, which states that a "parent may be liable for its subsidiary's conduct under traditional agency principles. The fundamental characteristic of agency is control." In evaluating the parent's control to determine whether a subsidiary is an agent of the parent, DOJ and SEC look at the parent's direction of the subsidiary's actions, both generally and in the context of a specific transaction. If an agency relationship exists, a subsidiary's actions and knowledge are imputed to its parent. Significantly, in determining whether an agency relationship exists, DOJ, and particularly SEC, have expanded the control analysis to apply to relatively common corporate interactions between parents and subsidiaries, such as the parent company setting the business and financial goals for the subsidiary; the parent company coordinating the legal, audit and compliance functions of the subsidiary; the subsidiary directly reporting to the

[6] See generally *Global-Tech Appliances, Inc. v. SEB S.A.*, 131 S. Ct. 2060 (2011).
[7] *United States v. Kozeny*, No. 09-cv-4704 (2d Cir. 14 December 2011).
[8] See *SEC v. Armor Holdings, Inc.*, No. 1:11-cv-01271 (D.D.C. 13 July 2011); Alcoa Inc., Exchange Act Release No. 71261 (9 January 2014).

parent company; and the parent company having general direction and control of the global business.

e. Exceptions and Affirmative Defenses

i. Facilitation Payment Exception

There is one limited exception to the anti-bribery provisions of the FCPA, which applies to insubstantial payments made merely to expedite performance of "routine governmental action." Examples of routine government action include: clearing goods through customs; expediting the processing of permits, licenses, or other official documents that the payor is legally entitled to receive; processing governmental papers, such as visas and work orders; providing police protection; mail pick-up and delivery; providing phone service, power and water supply; loading and unloading cargo, or protecting perishable products; and scheduling inspections associated with contract performance or transit of goods across country. Routine government action does *not* include any decision by a foreign official to award new business or to continue business with a particular entity. What is contemplated are non-discretionary acts of lower-level officials, generally limited to ministerial or clerical acts that expedite the processing of a matter.

The guidance confirms that U.S. authorities will strictly enforce the requirements of the facilitation payments exception. It reasserts the well-recognized definition that such payments are statutorily limited to routine, non-discretionary acts of government officials. Whether the payment can properly be characterized as a facilitating payment does not depend on its size, but rather on the purpose of the payment. The guidance cites examples of cases in which the payment was deemed a bribe, and not a facilitating payment, where the purpose of the payment was to clear goods, avoid inspection, or reduce or eliminate customs duties – rather than merely expedite a routine, non-discretionary government action. Moreover, the guidance clearly discourages the use of these payments even if the exception is properly invoked. It notes that facilitation payments violate local law in most countries, that they violate the UK Bribery Act of 2010 (the UK Bribery Act), and that the U.S. has regularly discouraged their use pursuant to the recommendations of the OECD Working Group on Bribery in International Business Transactions (OECD Working Group).

ii. Affirmative Defenses

There are also two affirmative defenses under the FCPA. The first affirmative defense is that the payment was lawful under the written laws of the foreign country. Whether a payment was lawful under the written laws of the foreign country may be difficult to determine, particularly in cases involving such issues as (i) the issuance of an advisory opinion by a foreign governmental agency; (ii) the issuance of regulations by a unit of local government; and (iii) a course of conduct of a foreign government or government agency as reflected in its written pronouncements that indicates the payment is legal. DOJ has traditionally applied this exception very restrictively, by requiring a high degree of specificity in the foreign law.

The second affirmative defense is that the payments were made for "reasonable and bona fide" expenses, such as travel or lodging directly related to the promotion or demonstration of products or services, or related to the performance of a contract with the foreign government. A party asserting this affirmative defense will be required to demonstrate a reasonable basis for incurring such "hospitality" expenses.

3. Accounting Provisions of the FCPA

In addition to the anti-bribery provisions, the FCPA also amended Section 13 of the Exchange Act, by adding a new section 13(b)(2), which contains section 13(b)(2)(A), the "books and records" section, and section 13(b)(2)(B), the "system of internal accounting controls" section. These are collectively known as the FCPA accounting provisions.

a. Books and Records Provisions

Section 13(b)(2)(A) requires issuers whose securities are registered under the Exchange Act, or who otherwise make periodic filings with SEC, to "make and keep books and records, and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions" of assets.[9] SEC Rule 13b2-1, promulgated pursuant to section 13(b)(2), further provides "[n]o person shall directly or indirectly falsify or cause to be falsified, any book, record or account subject to section 13(b)(2)(A)."[10]

Section 13(b)(2)(A) of the Exchange Act has three basic objectives: (1) books and records should reflect transactions in conformity with accepted methods of reporting economic events; (2) financial books and records should not reflect misrepresentation, concealment, falsification, circumvention or other deliberate acts resulting in inaccuracies; and (3) transactions should be properly reflected on the books and records, in such a manner as to permit the preparation of financial statements in conformity with generally accepted accounting principles and other criteria applicable to such statements.[11] SEC imposes a reasonableness standard, rather than a materiality standard, when enforcing this provision because the conduct that the section was intended to prevent, such as the use of slush funds, payment of off-the-book expenses, and approval of unusual payments, may not rise to the level of financial statement materiality. These requirements extend not only to an Issuer's financial records but also to its contracting policies and procedures.

b. Internal Controls Provisions

Section 13(b)(2)(B) of the Exchange Act generally requires Issuers to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that certain requirements set forth in the section are met. The internal accounting control practices should "provide reasonable, cost-effective safeguards against the unauthorized use or disposition of company assets and reasonable assurances that financial records and accounts are sufficiently reliable for purposes of external reporting."[12]

The FCPA requires an Issuer holding 50 percent or less of the voting power of a subsidiary to use its influence, to the extent reasonable under the circumstances, to cause the subsidiary to devise and maintain a system of adequate internal accounting controls. Such circumstances

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[9] 15 USC § 78m(n)(2)(A).
[10] 17 CFR § 40.13b2-1.
[11] *SEC v. World-Wide Coin Investments, Ltd.*, 567 F. Supp. 724, 748 (N.D. Ga. 1983).
[12] *Id*. at 750.

include the relative degree of ownership of the subsidiary and the laws and practices of the foreign country in which the subsidiary is located. An Issuer demonstrating good faith efforts to use such influence will be "conclusively presumed" to have complied with the requirements of the accounting provisions.[13]

4. Penalties for Violation

a. Enforcement

DOJ is responsible for all criminal enforcement of the FCPA with respect to Issuers, and for civil and criminal enforcement of the anti-bribery provisions. SEC is responsible for civil enforcement of the anti-bribery provisions with respect to Issuers. SEC is also responsible for civil enforcement of the accounting provisions of the FCPA.

b. Criminal Penalties

The FCPA's criminal provisions subject firms to fines of up to US$2 million per count, while individuals such as officers, directors, stockholders, employees and agents are subject to fines of up to US$100,000 per count and imprisonment for up to five years. Each payment is generally considered a separate count, even if made in connection with one transaction. Fines imposed on individuals may not be paid by the firm, so that routine corporate indemnification for officers and directors would not be available. The 1998 amendments extend criminal liability under the FCPA to foreign national employees or agents of U.S. companies, who previously were subject only to civil sanctions.

An alternative maximum fine may be imposed in cases where a person derives pecuniary gain from the offense or where the offense results in pecuniary loss to a person other than the defendant.[14] In such cases, the maximum fine is not more than the greater of twice the gross gain or loss. Determination of these amounts can be difficult, but it is clear that where improper payments result in the award of large contracts, maximum fines can increase substantially beyond the figures referenced above.

c. Federal Sentencing Guidelines

Although the penalties described above are the statutory maximums, the actual sentence that an individual or an organization would receive is determined by the U.S. Sentencing Guidelines (the Sentencing Guidelines). Under the Sentencing Guidelines, fines are generally based on the amount of money involved in the bribe or the amount of the bribe, and are in addition to any restitution if there is a victim that suffered a loss as a result of the violation. For individuals, any sentence of imprisonment is based on the offense level assigned to the particular violation and the criminal history of the defendant. The offense level takes into account the characteristics of the offense, such as the value of the bribe or benefit obtained, and the particular defendant's role in the offense. For organizations, the factors used to determine the applicable sentence include the value of the bribe and benefit obtained, prior corporate misconduct, the existence of an effective

[13] 15 USC § 78m(b)(6).
[14] 18 USC § 3571(d).

compliance program, and the degree of cooperation given during the investigation. Federal judges have very limited discretion to impose a sentence that varies from the calculated range under the Sentencing Guidelines.

d. Civil Penalties

The U.S. Attorney General or SEC, as appropriate, may bring a civil action for injunctive relief and fines of up to US$10,000 per violation against any firm, or any officer, director, employee, agent, or stockholder acting on behalf of the firm. In addition, in an SEC enforcement action, the court may impose an additional fine not to exceed the greater of (1) the gross amount of the pecuniary gain to the defendant as a result of the violation; or (2) a specified dollar limitation, ranging from US$5,000 to US$100,000 for an individual and US$50,000 to US$500,000 for any legal entity.

e. Disgorgement

Technically, disgorgement is not a penalty but, rather, an equitable remedy under the Exchange Act that is used to prevent unjust enrichment and deter violations of federal securities law. However, disgorgement amounts can dwarf civil penalties, which is why in most parallel SEC and DOJ resolutions, disgorgement is ordered in the SEC civil case, while any monetary fines and penalties are ordered in the DOJ criminal case. Most recently, Avon's December 2014 US$135 million settlement with DOJ and SEC included disgorgement of US$52.85 million to SEC, plus prejudgment interest of US$14.5 million. Avon was ordered to pay a US$67.7 million criminal fine to DOJ.

In calculating disgorgement, SEC is required to distinguish between legally and illegally obtained profits. However, in most cases, it is a near-impossible task to precisely separate legal from illegal profits. Accordingly, SEC only needs to show a reasonable approximation of profits causally connected to the violation. Once SEC does so, the burden then shifts to the defendant to demonstrate SEC's estimate is not a reasonable approximation of the unjust enrichment. Defendants can make this showing by pointing to intervening events from the time of the violation, but SEC is not required to accept these submissions.

f. Additional Consequences

A person or firm found to be in violation of the FCPA may also be barred from doing business with the U.S. federal government and may be ruled ineligible to receive export licenses. In addition, SEC may suspend or bar persons from the securities business, and the Commodity Futures Trading Commission and the Overseas Private Investment Corporation may suspend or debar the entity from agency programs. A violation may also disqualify the firm from obtaining financing from multilateral financial institutions, such as the European Bank for Reconstruction and Development (EBRD) or the International Finance Corporation (IFC). A payment made to a foreign government official that is unlawful under the FCPA also cannot be deducted under the tax laws as a business expense. Thus, an improper deduction may expose a company to tax penalties.

B. Aggressive Application of the FCPA Jurisdictional Reach by the U.S. Authorities

Over the last few years, U.S. authorities have taken an increasingly aggressive approach toward asserting jurisdiction over persons and companies that historically never would have been considered subject to U.S. control. In practice, U.S. authorities can more often than not find a jurisdictional "hook" allowing them to pursue an enforcement action, as evidenced by the numerous FCPA cases brought against non-U.S. companies. Because these cases inevitably end in a settlement agreement, there is little case law testing the boundaries of DOJ and SEC jurisdiction under the FCPA. Furthermore, recent SEC matters involving foreign nationals illustrate the broad interpretation by U.S. authorities of the scope of conduct sufficient to establish personal jurisdiction in the civil context.

1. Jurisdictional Reach of the FCPA

As discussed above, the anti-bribery provisions of the FCPA apply to Issuers (i.e., publicly traded companies required to file reports with SEC), Domestic Concerns, and foreign nationals and entities that violate the FCPA while in the territory of the U.S. In any FCPA enforcement action, the government must establish that the alleged conduct meets one of several jurisdictional bases contained in the statute. Of course, when the action ends in a settlement, the government's jurisdictional evidence and theory are never actually tested in court.

2. Jurisdictional Predicates under the FCPA

a. Nationality Jurisdiction

In order to comprehend the reach of the FCPA's anti-bribery provisions, it is vital to understand the two primary bases for jurisdiction under the FCPA. The first basis is a form of *nationality jurisdiction*, which provides for jurisdiction over acts by Issuers and Domestic Concerns regardless of where they take place. Prior to the 1998 amendments to the FCPA, the government had to prove that the issuer or domestic concern used a means or instrumentality of interstate commerce (e.g., telephone/fax lines, mail, email, wire transfer) in furtherance of a violation. In 1998, to conform with the OECD Convention, the interstate commerce requirement was eliminated for Issuers and Domestic Concerns for acts that occurred wholly outside of the U.S. Nevertheless, U.S. authorities must still demonstrate the use of a means or instrumentality of interstate commerce for conduct committed by Issuers and Domestic Concerns inside the U.S.

b. Territorial Jurisdiction

The second principal basis for jurisdiction is *territorial jurisdiction*, which provides for jurisdiction when a foreign national or entity uses a means or instrumentality of interstate commerce, or commits an act in furtherance of a violation, while in the territory of the U.S. This basis for jurisdiction was introduced in the 1998 amendments to the FCPA, and it greatly expanded the jurisdiction of U.S. authorities to prosecute non-U.S. companies and nationals. This provision expressly requires that the use of the mails or means of interstate commerce, or some other act in furtherance of an improper payment, take place while the foreign person or entity is *in the territory* of the U.S. According to the guidance, the requisite territorial nexus is satisfied if an agent commits an act in furtherance of an improper payment in the U.S., even if the non-U.S. company itself takes no action in U.S. territory.

The expansive approach to jurisdiction underlying FCPA enforcement has not abated. In the past, FCPA enforcement actions were typically brought against corporate defendants that were either Issuers or Domestic Concerns. In recent years, however, U.S. authorities have increasingly investigated and prosecuted foreign persons and entities using more attenuated bases of jurisdiction, including minimal acts in furtherance of a corrupt payment having taken place in the U.S., aiding and abetting a violation of the FCPA, and participation in a conspiracy to violate the FCPA.

c. Jurisdiction Based on Acts Committed in U.S. "Territory"

As stated above, a non-U.S. person or company may face liability under the FCPA for using U.S. mails or emails that touch a U.S.-based server, or carrying out some other act in furtherance of an improper payment *while in the territory* of the U.S. In practice, U.S. authorities have asserted in numerous precedents that any action undertaken by a foreign company abroad that causes something to be done in the U.S. (e.g., wire transfer, phone call, correspondent banking transaction) is sufficient for establishing jurisdiction, no matter how minimal the nexus of the U.S. conduct. In this context, U.S. authorities seem intent on pushing the jurisdictional bounds of the FCPA, and the link between the behavior in question and U.S. territory is becoming increasingly tenuous.

One example of the extraterritorial application of the FCPA is DOJ's criminal enforcement actions brought against several non-U.S. subsidiaries of Siemens.[15] The prosecutions appear to have been based on conduct only loosely connected to the U.S., including the employment of a U.S. agent, the use of U.S. bank accounts, and the use of U.S. mails and telephone lines. Such conduct may be viewed as satisfying the traditional interstate commerce requirement, which is one of the elements on which territorial jurisdiction may be based under the FCPA. What is less clear is whether, if tested in litigation, this conduct could withstand a challenge to the requirement that a company or individual acted while in the territory of the U.S.

Another example is the prosecution of individuals related to TSKJ, a Nigerian joint venture formed by Technip, Snamprogetti Netherlands, Kellogg Brown & Root (KBR), and JGC Corp.[16] DOJ and SEC alleged that KBR executives acted in furtherance of the bribery scheme within and outside the territory of the U.S. In each of the charged financial transactions, the funds in question were transferred from a bank account in Amsterdam to agents' accounts in Japan, Monaco or Switzerland. The pleadings did not allege that any of the relevant banks were located in the U.S. or that funds were held at U.S. banks; instead, the sole alleged jurisdictional connection for the substantive FCPA counts was that the transfers were denominated in U.S. dollars and therefore were transferred "via a correspondent bank account in New York, New York."

[15] *United States v. Siemens Aktiengesellschaft*, No. 08-CR-367 (D.D.C. 12 December 2008); *United States v. Siemens S.A. (Argentina)*, No. 08-CR-368 (D.D.C. 12 December 2008); *United States v. Siemens Bangladesh Ltd.*, No. 08-CR-369 (12 December 2008); *United States v. Siemens S.A. (Venezuela)*, No. 08-CR-370 (D.D.C. 12 December 2008).
[16] See *United States v. Stanley*, No. 08-CR-0597 (S.D. Tex. 29 August 2008); *United States v. Tesler*, No. 09-CR-0098 (S.D. Tex. 17 February 2009).

DOJ's aggressive jurisdictional claims on the "territory" prong have not been entirely successful. In 2011, District Judge Richard Leon dismissed a charge against one of the "Africa Sting case" defendants, due to a lack of jurisdiction.[17] The defendant, Pankesh Patel, is a UK citizen and employee of a UK company. DOJ's asserted jurisdictional hook was that he sent a DHL package from the United Kingdom to Washington, DC "containing one original copy of the purchase agreements for the corrupt Phase Two deal."[18] After a colloquy with the parties, in which he suggested DOJ's jurisdictional claim was "novel," Judge Leon dismissed the related count. Although this was only an unpublished ruling by a district court in an area largely devoid of judicial rulings, this decision serves as an important marker for future DOJ jurisdictional claims.

d. Agency Theory

In another move to assert jurisdiction over conduct that would have previously been considered outside the reach of the criminal provisions of the FCPA, DOJ and SEC suggested in the guidance that a parent company may be held liable for the acts of its subsidiaries under agency principles, even if the parent was not itself involved in the misconduct. According to the guidance, depending on the parent's knowledge and direction of the subsidiary's actions, both generally and in the context of the specific transaction, the subsidiary's actions and knowledge are imputed to the parent. This position is potentially a significant departure from prior expectations that the parent would only be criminally liable if it had knowledge or direct involvement in the corrupt scheme.

e. Aiding and Abetting and Agency Theories

Federal prosecutors have further stretched their FCPA jurisdictional boundaries by charging individuals and companies with inchoate offenses where they would not otherwise be subject to FCPA liability. According to the guidance, a "foreign national or company may . . . be liable under the FCPA if it aids and abets, conspires with, or acts as an agent of an issuer or domestic concern, regardless of whether the foreign national or company itself takes any action in the United States."

SEC ploughed new precedential ground when it charged Panalpina, Inc., a U.S.-based company that was neither an Issuer nor part of a U.S.-listed foreign company.[19] The case marked the first instance of SEC asserting jurisdiction over a non-Issuer company that was not a subsidiary of an Issuer. SEC based its assertion of jurisdiction over Panalpina on the fact that the company was an agent of Issuer clients, and aided and abetted FCPA violations committed by those clients. In addition to this theory of liability, SEC charged Panalpina with primary liability under the FCPA, as a result of its actions as an agent for certain of its issuer-customers. Thus, even though SEC would not otherwise have had jurisdiction over Panalpina as a non-Issuer, it was able to bring a substantive FCPA charge against Panalpina as an agent for its Issuer-customers, in addition to an aiding and abetting claim.

SEC also brought an administrative action against United Industrial Corp., for bribes paid by the president of its wholly owned subsidiary where the subsidiary's president reported directly to

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[17] See Order Granting in Part Motion for Judgment of Acquittal, *United v. Patel*, No. 09-338 (D.D.C. 6 June 2011).
[18] See Indictment, *United States v. Patel*, No. 09-338, (D.D.C. 11 December 2009), p. 11.
[19] Civil Complaint, *SEC v. Panalpina, Inc.*, (S.D. Tex. Nov. 4, 2010).

the parent's CEO and was identified as a member of the parent's senior management.[20] United Industrial Corp.'s legal department also had approved the retention of the third party through which the bribes were paid, and an official of the parent company approved one of the payments to the third-party agent. Given these factors, SEC asserted that the subsidiary was acting as the parent company's agent, and hence the parent was liable for the bribes paid by the subsidiary.

f. Conspiracy

Conspiracy can also be used to establish FCPA jurisdiction over companies or individuals. Under U.S. law, each co-conspirator is liable for all of the foreseeable acts in furtherance of the conspiracy by every other conspirator. If U.S. authorities can establish jurisdiction over one conspirator, they have jurisdiction over all members of the conspiracy, regardless of the location of the latter members. This concept has been applied in several recent FCPA enforcement actions, including one against Alcatel, where several non-U.S. subsidiaries were charged with conspiracy to violate the FCPA, and DOJ alleged that "at least one of the co-conspirators committed or caused to be committed" various acts in the U.S.[21] In support, DOJ cited meetings, emails, and phone calls that Alcatel personnel had with individuals in Miami, Florida. They also detailed a series of wire transfers that included payments made from U.S. bank accounts and payments made from foreign accounts routed through U.S. correspondent accounts.

3. Personal Jurisdiction in Civil Actions

In order to bring a civil enforcement action, SEC must establish personal jurisdiction over a corporate or individual defendant. Personal jurisdiction is typically not an issue when defendants are U.S. residents or companies organized or operating in the U.S. In the case of foreign individuals and corporations, however, it may be more difficult to demonstrate that personal jurisdiction exists.

The touchstone of personal jurisdiction is "minimum contacts," which, in the federal context, means contacts with the U.S. as a whole. A court will find that a defendant has the requisite minimum contacts with the U.S. if (i) the claim against the defendant arises out of or relates to those contacts; and (ii) the defendant deliberately took advantage of the opportunity to do business in the U.S. If a defendant's conduct meets that standard, a court will likely find that it has personal jurisdiction, unless the defendant can show that doing so would be unreasonable (i.e., due to an undue burden on the defendant or the interests of a different forum).

Two recent civil FCPA actions against individual defendants tested the question of personal jurisdiction, and provide useful insight into the broad view of jurisdiction held by U.S. enforcement authorities and the judicial limitations on that view.

The court in *SEC v. Straub et al*. denied the defendants' motion to dismiss for lack of personal jurisdiction, finding that, if the SEC's factual assertions proved true, the court would have personal jurisdiction over the defendants.[22] The judge noted that the defendants made false statements regarding disposition of the assets of their company – Magyar Telekom – that were

[20] Admin. Proceeding Order, *In the Matter of United Industrial Corp.*, Exchange Act Release No. 60005 (29 May 2009).
[21] Deferred Prosecution Agreement, *United States v. Alcatel-Lucent, S.A.*, No. 10-CR-20907 (S.D. Fl. 27 December 2010).
[22] *SEC v. Straub*, 921 F. Supp. 2d 244, 255 (S.D.N.Y. 2013).

being used in furtherance of the alleged bribery scheme. These false statements were then incorporated into the books and SEC filings of Magyar's parent company, Deutsche Telekom. Even though the bribery scheme occurred predominantly in a different country, the defendants engaged in conduct designed to violate U.S. securities laws. The judge specifically stressed that the defendants' concealment of the scheme from auditors and superiors – while knowing that false information would be provided to prospective U.S. investors – would be sufficient to assert personal jurisdiction.

In *SEC v. Sharef*, the court ruled that it did not have personal jurisdiction over one of the defendants – all former Siemens executives – because the defendant lacked sufficient "minimum contacts" with the U.S.[23] Similar to Magyar, in the Siemens case, a local bribe scheme in Argentina was inaccurately incorporated into the company's books and SEC filings, and participants in the scheme filed Sarbanes-Oxley Act certifications that they knew were false. One defendant, Herbert Steffen, had a less significant role, and merely pressured one of the other defendants to authorize the bribes to Argentinian officials. SEC argued that Steffen's promotion of the bribery scheme proximately caused the false filings with the SEC (a claim to which the judge responded skeptically). The judge ruled, however, that even assuming Steffen's actions proximately caused the false filings, his actions were "far too attenuated from the resulting harm" to constitute minimum contacts. The judge cited *Straub* approvingly but distinguished the facts by emphasizing that Steffen's actions were not directed at deceiving U.S. shareholders and that he did not authorize the bribe, direct the cover-up or play any role in the falsified filings. The judge reasoned that minimum contacts may not arise merely from illegal conduct that ultimately has an effect on SEC filings – or else every participant in unlawful conduct by a foreign issuer would be subject to the jurisdiction of U.S. courts.

The *Straub* and *Sharef* cases are instructive on personal jurisdiction in the FCPA context. First, they underscore how far personal jurisdiction can extend for issuers in civil enforcement actions. Both cases strongly suggest that potential wrongdoing by anyone who signs the certifications required under Section 302 of Sarbanes-Oxley Act could act as a "trigger" to personal jurisdiction. Second, these cases – particularly *Sharef* – reveal SEC's internal thinking on the extent of its power to reach foreign individuals and entities. SEC's position appears to be that any involvement in a bribery scheme that affects an issuer falls within the agency's enforcement authority. Despite losing the argument in *Sharef*, SEC will likely continue to adhere to this position.

4. Conclusion

Foreign companies and individuals attempting to evaluate their level of exposure under the FCPA should proceed under the assumption that U.S. authorities will pursue an expansive jurisdictional theory in pursuit of an enforcement action. Moreover, the investigative tools available to DOJ and SEC, coupled with the substantial litigation risk for target companies and individuals, enable authorities to place pressure on foreign companies before the issue of jurisdiction is ever tested in court.

[23] *SEC v. Sharef*, No. 11-civ-9073 (S.D.N.Y. 19 February 2013).

Most foreign companies concerned about the FCPA likely face similar anti-bribery laws in their home countries, albeit with a lower level of enforcement activity. While a company should evaluate home jurisdiction conditions when calibrating the appropriate degree of action to take in order to minimize FCPA risks, the strategy should be one that proactively addresses and mitigates corruption risks, rather than attempting to avoid categorically U.S. jurisdiction.

C. Other Relevant U.S. Criminal Laws

Federal prosecutors sometimes rely on other anti-corruption statutes instead of – or in combination with – FCPA charges. Wire and mail fraud statutes provide additional theories to prosecute foreign bribery. The elements of wire or mail fraud are (1) a scheme to defraud; (2) knowing participation in the scheme with intent to defraud; and (3) the use of the mails or wires to execute the scheme. For instance, DOJ has recently announced charges against individuals relating to the PetroTiger Ltd. bribes to a Colombian state-owned petroleum company that included both FCPA and wire fraud counts.[24]

The Travel Act, 18 USC. §1952, prohibits travel in interstate or foreign commerce, or the use of the mails or any facility in interstate or foreign commerce, with the intent to promote, manage, establish, or carry on any “unlawful activity.” “Unlawful activity” includes bribery in violation of either federal or state law, and thus an FCPA violation can also form the basis for a Travel Act charge. For example, DOJ prosecuted the former CEO of Saybolt, Inc. for violating both the FCPA and the Travel Act by bribing a Panamanian government official to help secure government concessions relating to a land deal.[25] In that case, the Travel Act charge was premised on New Jersey’s commercial bribery statute, although, in another case, DOJ has also brought Travel Act charges purely based on a violation of the FCPA.[26] Indeed, even where the Travel Act has not been explicitly charged, and where there is evidence of commercial bribery and bribery of foreign officials, DOJ sometimes makes corporate settlement agreements contingent on implementation of corporate compliance programs designed to detect and prevent violations of the FCPA and commercial bribery laws.[27]

Money laundering charges may also be filed against a person alleged to have violated the FCPA.[28] Under federal criminal law, money laundering can consist of transferring or sending funds abroad with the intent to carry out some “specified unlawful activity,” “ including violation of the FCPA, as defined in the statute. Engaging in financial transactions with the proceeds of such specified unlawful activity (e.g., any revenues received as a result of an improper payment) constitutes one of several possible alternative bases for money laundering charges.

Money laundering is a predicate offense to violation of the Racketeer Influenced and Corrupt Organization Act (RICO), which may provide the basis for further criminal charges against an FCPA defendant. Such a violation may also give rise to a private cause of action for treble damages under the RICO, or to actions under other federal or state laws. For example, an action

[24] *United States v. Joseph Sigelman*, No. 14-CR-00263 (D.N.J. 8 November 2013); *United States v. Gregory Weisman*, No. 13-CR-00730 (D.N.J. 8 November 2013).
[25] *United States v. Mead*, No. 3:98-cr-00240 (D.N.J. 16 October 1998).
[26] See, e.g., *United States v. Kozeny*, No. 1:05-cr-00518 (S.D.N.Y 12 May 2005).
[27] See, e.g., Schnitzer Steel Industries Inc. Deferred Prosecution Agreement (19 October 2006).
[28] The anti-money laundering statute is at 18 USC § 1956.

might be brought under the RICO by a competitor who alleges that the bribery caused the defendant to win a foreign contract that the competitor would otherwise have won.

Occasionally, these statutes will be employed precisely because the FCPA does not cover the misconduct. For instance, even though foreign officials themselves cannot be prosecuted under the FCPA for taking bribes, three former Haitian officials accused of accepting bribes from a Miami-based telecommunications company were convicted in 2011 of money laundering offenses.[29] The Miami-based executives had been convicted of FCPA and money laundering offenses.

As the cases described above indicate, the fact development that occurs during the investigative stage typically yields an evidentiary basis for pursuing charges against a company, using multiple legal theories other than (or in addition to) substantive FCPA charges.

D. Globalization of FCPA Standards

1. OECD Convention

Much of the criticism of the FCPA by the American business community has focused on the disadvantages to U.S. firms relative to firms whose home countries do not similarly prohibit international bribery. In an effort to eliminate these disparities, the U.S. government has long advocated the adoption of stronger anti-corruption legislation by the world's major economic powers. This effort led to the signing, on 17 December 1997, of the OECD Convention by the OECD's 29 member states and several observer states. By entering into the OECD Convention, these nations obligated themselves to pass domestic legislation criminalizing bribery of foreign officials. As noted above, the U.S., a signatory to the OECD Convention, amended the FCPA in 1998 to bring U.S. law into compliance with the terms of the OECD Convention.

The OECD Convention requires signatories to adopt and implement legal and policy measures to prevent, investigate and prosecute bribery of foreign public officials. Among other things, it requires signatories to criminalize foreign bribery committed by individuals and to establish sufficient liability, be it criminal, civil or administrative, for corporations and legal entities that engage in foreign bribery of public officials. The convention also obliges signatories to provide prompt international legal assistance for investigating and prosecuting foreign bribery, and to impose effective, proportionate and dissuasive sanctions for foreign bribery, including confiscation of bribes and any proceeds obtained through bribery.

Significantly, the OECD Convention defines "foreign public official" very broadly, to include any person exercising a public function for a foreign country, such as a public agency or public enterprise, and any official or agent of a public international organization. Also, in contrast to the FCPA, it does not include any exception for so-called "facilitation payments." As of the time of writing, the 34 members of the OECD and seven non-member countries – Argentina, Brazil, Bulgaria, Colombia, Latvia, Russia and South Africa – have adopted the OECD Convention.

In 1994, the OECD established the Working Group, which subsequently acquired responsibility for overseeing implementation of the OECD Convention. The OECD Working Group meets regularly to monitor the efforts of signatories to implement the convention. A crucial element of the monitoring is the OECD Working Group's rigorous country peer-review process.

[29] See Judgments *United States v. Esquenazi*, No. 09-cr-21010, ECF Nos. 182, 816, 824 (S.D. Fla. 5 August 2011).

In addition to conducting peer reviews, the OECD Working Group periodically makes recommendations on best practices in anti-corruption. In 2009, it released its Recommendation for Further Combating Bribery of Foreign Public Officials (2009 recommendation). Among other things, the 2009 recommendation:

- urges all countries to raise awareness of their public officials on their domestic bribery and solicitation laws, with a view to stopping the solicitation and acceptance of small facilitation payments;
- recommends that countries review their policies and approach on small facilitation payments, in order to combat this phenomenon and encourage companies to prohibit or discourage the use of small facilitation payments in internal company controls and compliance programs;
- urges countries to disallow explicitly the tax deductibility of bribes to foreign public officials;
- recommends that countries ensure that easily accessible channels are in place for the reporting of suspected acts of foreign bribery;
- recommends that countries ensure that accounting requirements are adequate to prevent off-the-books transactions that can be used to conceal bribe payments, and to encourage companies to develop and adopt adequate internal controls for the purpose of preventing and detecting foreign bribery; and
- instructs the OECD Working Group to carry out an ongoing program of systematic follow-up, to monitor and promote the full implementation of the OECD Convention.

The 2009 recommendation also includes the OECD's Good Practice Guidance on Internal Controls, Ethics and Compliance (the good practice guidance) on the implementation of specific aspects of the OECD Convention (Annex I) and for companies on internal controls, ethics and compliance (Annex II). Among other things, Annex I explains that the OECD Convention should be implemented in such a way that it does not provide a defense or exception where the foreign public official solicits a bribe, and that member countries should ensure that legal entities cannot avoid liability by using intermediaries, including related legal persons, to offer, promise or give a bribe to a foreign public official on its behalf.

Annex II includes specific recommendations to companies on establishing effective internal compliance controls to prevent bribery. These recommendations synthesize best practices from businesses and legislation throughout the world, and provide a useful roadmap for companies seeking to establish effective compliance programs that meet all relevant international standards. They are discussed in more detail below.

The cumulative effect of the OECD Convention and the OECD Working Group has been to promote the adoption and enforcement of FCPA-like laws throughout the world. As a result, companies operating internationally must be careful to comply not just with the FCPA, but also with local laws in the countries in which they operate.

2. Increased Cooperation between the U.S. and Foreign Authorities

Inherently, international instances of corruption are likely to touch on multiple jurisdictions, particularly when they involve multinational companies with decentralized business operations. A multinational company will often have global operations that bring it within the jurisdiction of several countries' regimes simultaneously. This trend is increasing, due to globalization of international communications and business operations, and through the practice of companies outsourcing and offshoring non-core functions.

This means that a company that discovers a corruption issue may face the prospect of having to make a decision on whether or not to disclose that issue to several authorities, all of which have simultaneous jurisdiction over the company and the conduct. Parallel cross-border investigations, cooperation and enforcement are increasingly common among law enforcement agencies of different countries, with information sharing particularly among signatories to the OECD Convention, pursuant to formal Mutual Legal Assistance Treaty requests, or other less formal requests for information and assistance. Recent FCPA settlements indicate such cooperation between DOJ and SEC and their international counterparts, including U.S. cooperation with France in the May 2013 settlement with Total S.A.; with Germany, Poland and Mexico in the April 2014 settlement with Hewlett Packard; and with authorities in Indonesia, Switzerland, the UK, and several other countries, in the December 2014 settlement with Alstom. These cases will also likely involve parallel enforcement in other countries. There appear to be more cases in the pipeline, with current investigations into UK-headquartered jet engine manufacturer Rolls-Royce and pharmaceutical company GlaxoSmithKline likely to face enforcement action on both sides of the Atlantic, as well as in Asia, where the bribery is alleged to have occurred.

Assistant Attorney General Leslie R. Caldwell's remarks at the November 2014 American Conference Institute's 31st International Conference on the Foreign Corrupt Practices Act further suggest that this trend will continue. Assistant Attorney General Caldwell focused her speech on the increased collaboration between law enforcement and regulatory authorities in the U.S. and foreign counterparts, stating that "we share information about bribery schemes," "report schemes to one other," and "where appropriate, we discuss strategy and coordinate our use of investigative techniques, so that we can obtain the best possible results, especially in very high-impact cases." This international approach, according to Assistant Attorney General Caldwell, "has dramatically advanced our efforts to uncover, punish and deter foreign corruption."

In addition to foreign jurisdictions, the U.S. has been working with the world's major international financial institutions (IFIs), such as the World Bank and Asian Development Bank, to combat corruption that stifles economic development intended to stamp out poverty and improve infrastructure and livelihoods. The main IFIs (the World Bank, EBRD, African Development Bank, Asian Development Bank, Inter-American Development Bank and the European Investment Bank) entered into a cross-debarment agreement, under which certain debarment sanctions by any one of the participating IFIs will result in mandatory cross debarment by the other participating IFIs – even if the violation relates to only one IFI.

Because the World Bank and other IFIs lack subpoena power, many of them have signed cooperative agreements to gain access to relevant information or to information gathered by national authorities. The World Bank has entered into 26 memoranda of understanding with national authorities and development organizations around the world to formalize the exchange of information, lay groundwork for parallel investigations and refer cases to national authorities for prosecution. IFIs have entered into cooperation agreements with the European Anti-Fraud Office, the UK Serious Fraud Office (SFO), the International Criminal Court, the International Criminal Police Organization (INTERPOL), the United Nations Development Programme (UNDP) Office of Audit and Investigations, the U.S. Agency for International Development (USAID) and the Australian Agency for International Development (AUSAID), to name a few. In 2014, the World Bank made 22 referrals of findings to agencies and authorities in more than 20 countries.

Overlapping jurisdictions can, however, bring potential challenges for prosecutors, who have to take into account, among other issues, conflict of laws and rules on double jeopardy when a company or an individual is being pursued, or has already been prosecuted, for the same conduct in a different country, or where there is competing jurisdiction over the same conduct. It remains to be seen exactly how national regulators will react to increasingly common situations of competing jurisdiction where several authorities may want to pursue simultaneously the same high-profile case, and may have competing interests in taking the lead. The OECD Convention, which forms the basis of international cooperation on the topic, provides little concrete guidance, stating simply, at article 4.3, that: "*When more than one Party has jurisdiction over an alleged offence described in this Convention, the Parties involved shall, at the request of one of them, consult with a view to determining the most appropriate jurisdiction for prosecution*."

There continue to be challenges. Just weeks before DOJ and SEC announced their US$384 million settlement with U.S. aluminum company Alcoa in January 2014, the trial of Victor Dahdaleh, a London-based consultant who had been under investigation by the UK SFO for four years in relation to the same conduct, collapsed in London. The SFO withdrew the case, to much criticism over its handling of the matter, in part because two U.S. lawyers refused to give evidence in London, as they were simultaneously advising on a civil action against Dahdaleh in the U.S.

III. Industry-specific Risks

The luxury goods and fashion industry is at relatively low risk for corruption, compared with industries with large volumes of sales to governments or state-owned enterprises in emerging markets (e.g., defense, pharmaceuticals and oil/gas). Nevertheless, there are some significant industry-specific risks. In this section, we analyze six of the most important: the risks associated with (1) gifts and hospitality; (2) customs clearance and logistics; (3) real estate and zoning licenses; (4) money laundering; (5) forced labor and corruption in the supply chain; and (6) combating counterfeit production. In identifying these as the six main risks, we do not mean to suggest that they are the only risks facing the industry, just that they are the most common and potentially the most serious. While these risks are significant, they can be mitigated by the measures recommended below. These recommendations are intended to supplement (and not replace) the more general compliance recommendations included elsewhere in this chapter.

1. Gifts and Hospitalities

The FCPA prohibits corruptly giving "anything of value" to foreign officials to obtain or retain business. "Anything of value" is defined broadly, to include travel expenses, expensive gifts and various non-tangible benefits. There is no minimum threshold amount. Although giving gifts such as product samples or product placements may be a common and legitimate form of marketing and promotion in the luxury and fashion industry, giving such gifts to government officials carries risks. As the guidance notes, several past FCPA enforcement actions have involved "single instances of large, extravagant gift-giving … such as sports cars, fur coats, and other luxury items.” Although the FCPA requires proof of corrupt intent and, as stated in the guidance, DOJ and SEC recognize that “[a] small gift or token of esteem or gratitude is often an appropriate way for business people to display respect for each other,” the guidance also states that “[t]he larger and more extravagant the gift … the more likely it was given with an improper purpose.” In other words, in the view of DOJ and SEC, the value of the gift is itself considered evidence of corrupt intent. This approach places the industry at special risk because the merchandise involved is, by definition, of high value.

Moreover, DOJ and SEC consider gifts and benefits cumulatively, rather than individually. For example, the guidance cites a case in which “a defendant gave a government official a country club membership fee and a generator, as well as household maintenance expenses, payment of cell phone bills, an automobile … and limousine services,” among other things. Although it is unlikely that any of these benefits alone would give rise to a DOJ or SEC enforcement action, taken collectively, the enforcement authorities considered them sufficient to constitute a possible violation.

The recent enforcement action against Avon by DOJ and SEC provides a good example of the risks associated with giving gifts to government officials. In that case, Avon’s Chinese subsidiary made US$8 million worth of payments in gifts, cash, travel and entertainment to Chinese government officials responsible for issuing direct selling licenses. The improper gifts included “paid travel for Chinese government officials within China or to the US or Europe as well as such gifts as Louis Vuitton merchandise, Gucci bags, Tiffany pens, and corporate box tickets to the China Open tennis tournament.” In return, Avon was awarded the first direct selling business license in China in March 2006. As a result of these violations, Avon paid a total of US$135 million in penalties to DOJ and SEC.

The FCPA acknowledges legitimate promotional expenses, and contains an affirmative defense that permits the payment of reasonable and *bona fide* expenses “where expenses are directly related to the promotion, demonstration, or explanation of a company’s products or services.” Under this defense, product samples of reasonable value can be provided to government officials at business meetings, or at other occasions where the purpose of such gifts is to promote, demonstrate or explain company products. For example, it may be perfectly appropriate for a manufacturer of champagne to give a bottle of its reasonably priced, mid-range product to a government official at a food convention, especially if other non-public officials also receive similar gifts. However, a case of the same product shipped to a foreign official’s home at the time when his or her office is considering a permit or a license would be problematic.

Reasonable and *bona fide* business expenses may include transportation and expenses to visit a company’s facilities or to attend meetings, product demonstrations, or other promotional activities. A trip whose primary purpose is personal entertainment for a foreign official or his or her family, however, is not a *bona fide* expense and would certainly raise concerns under the FCPA.

Companies can mitigate the risks associated with gifts and promotional expenses by (1) adopting and implementing policies and controls on gift giving that clearly specify permissible amounts, the circumstances under which gifts may be given and the approvals required for each category of gift; and (2) training their sales forces on these policies.

2. Customs and Logistics

The import and export of goods to and from emerging markets also presents significant corruption risks. Applicable rules and regulations may not be public and are often poorly drafted, leaving local officials with broad discretion in interpreting and applying them. Moreover, because clearance delays can have a significant negative impact on business, holding up shipments for technical reasons is a relatively easy way for corrupt customs inspectors to extort payments from local employees under pressure to meet tight deadlines.

The risks associated with customs clearance are increased by reliance on "customs brokers," and other third-party logistics providers who often, in turn, rely on subcontractors. Bribes paid by such third parties and their agents can be legally attributable to the company itself, even without direct proof that the company knew of the bribes. Evidence that the company had reason to know of a high likelihood of bribery and failed to stop it is generally sufficient to impose liability.

A good example of the risks associated with customs clearance is provided by the recent DOJ and SEC enforcement action against Ralph Lauren Corporation (RLC). In that case, RLC's Argentina subsidiary bribed customs officials over the course of five years in order to improperly clear goods through customs. The general manager of the subsidiary disguised the improper payments by channeling them through a customs clearance agency that provided invoices falsely describing the payments as, among other things, "Stamp Tax/Label Tax" and "Loading and Delivery Expenses." The payments were also part of a wider pattern of misconduct that included giving gifts to other government officials. As RLC acknowledged, pursuant to its settlements with DOJ and SEC, it failed (a) to perform adequate due diligence on its third-party intermediaries in Argentina; (b) to review adequately the authorization of reimbursement payments to third-parties; and (c) to implement an effective anti-corruption program or provide sufficient anti-corruption training to its Argentine subsidiary. As a result of these violations, RLC paid a US$882,000 fine to DOJ and disgorged approximately US$735,000 in profits to SEC.

To minimize the risks associated with customs clearance, companies should conduct meaningful due diligence on all customs agents, logistics providers and other third parties involved in the import and export of their goods. In order to ensure that misconduct is not simply moved down to the subcontractor level, companies should also ensure that they are notified of, and have the right to veto the use of, subcontractors employed by customs agents or logistics companies on their behalf.

When reviewing payments to logistics companies and customs clearance agents, companies should be especially wary of requests for lump sum payments and/or cash advances, charges that lack supporting documentation, and fines paid in cash or "negotiated." They should also be wary of any payments described as "special," "expediting," "unofficial," "facilitation," and the like, as such terms are often used to camouflage bribes. These risks can be mitigated by ensuring that the fee paid to any intermediary is at a market rate commensurate to the services rendered, and that contracts clearly specify the price to be paid for all services and prohibit any payments not specified in the contract. It is also important that companies monitor the activities of their local agents and, from time to time, exercise audit rights as part of these monitoring efforts. Finally, thorough advance planning of delivery and distribution schedules, in order to ensure that a sufficient supply of local inventory is always available, will reduce the company's vulnerability to extortion demands by customs officials.

3. Real Estate

Real estate transactions also present potential risks for the luxury and fashion industry. This is so because companies in this industry often seek premium real estate for their stores and offices and land and buildings in such locations are often subject to heavy regulation, requiring licenses, approvals and permits from multiple government agencies. Such interactions present corruption risks, especially when the job of getting the necessary approvals is outsourced to a local third party.

Press reports about the current Walmart investigation provide an example of some of the risks associated with real estate. In April 2012, the *New York Times* reported that Walmart de Mexico had, in connection with the opening of new stores, allegedly spent millions of dollars bribing local government officials through third parties. The *Times* reported that the payments were made to change zoning maps and obtain zoning approvals, reduce environmental impact fees, secure the allegiance of neighborhood leaders and obtain construction permits. Walmart has stated publicly that the investigation is ongoing and has expanded beyond Mexico.

Companies can best mitigate these risks by (1) understanding the local regulatory regime; (2) confirming that any fees they pay for permits are legal under local law; (3) ensuring that fees for services associated with obtaining such permits are set at an appropriate market rate; and (4) conducting due diligence on local counterparties and third-party agents, and using only reputable players with the appropriate expertise. To the extent possible, they should also try to identify options in different locations, so that they are not dependent on any particular government official for any particular permit.

Transactions involving real estate can also be risky because, in some countries, government officials conceal and/or collect illegal income through real estate holdings. In such circumstances, bribes are sometimes paid through excessive rents, or other fees associated with the properties, in exchange for regulatory approvals and other government actions in connection with the real estate. If this is the case, participating in such transactions may also subject the company to scrutiny for aiding and abetting money laundering. These risks can best be mitigated by (1) conducting thorough due diligence to identify the beneficial owner of the property that is being rented/leased/purchased; (2) obtaining anti-corruption and anti-money laundering certifications from agents and counterparties; and (3) ensuring that the amount paid is legal and commensurate with market rates.

4. Money Laundering

Companies in the luxury and fashion industry should also be aware of the risk that their products may be used in trade-based money laundering. In such schemes, drug money is converted into goods that are shipped to narcotics source countries and sold for cash, which is then delivered to drug trafficking organizations. According to the U.S. Financial Crimes Enforcement Network (FINCEN), the Los Angeles fashion district is rife with trade-based money laundering, mostly involving “Black Market Peso Exchange schemes.” In a series of raids on the LA fashion district on 10 September 2014, U.S. law enforcement officials seized almost US$90 million in currency believed to be the proceeds of drug trafficking. As a result, FINCEN issued a geographic targeting order (GTO), which requires nearly every business in the LA fashion district to (1) report any transaction in which it receives US$3,000 in cash; (2) verify the payor's identity against government-issued ID; and (3) obtain information regarding the principal for transactions conducted by an agent, including a phone number. Businesses subject to the GTO can be criminally prosecuted if they fail to comply with it.

These risks are obviously greater for retailers than for manufacturers or wholesalers. But the latter could find themselves dragged into investigations if they are consistently supplying retailers who are directly involved in trade-based money laundering. Such risks can be effectively managed through (1) distribution network due diligence and controls; and (2) spot monitoring of distributors and resellers. If a company learns that its products are being used in trade-based money laundering, it should inform law enforcement and cooperate in any investigation.

5. Forced Labor and Corruption in the Supply Chain

Supply chains can also generate risks for companies in the luxury and fashion industry. Most significant is the risk that forced labor may be used in the supply chain. This risk is especially great for companies that outsource production to countries with cheap labor supplies and insufficient legal protections for workers. A recent study by the International Labor Organization estimates that 21 million people are exploited in forced labor, generating US$150 billion annually in illegal profits. The Obama administration has made combating forced labor a priority, and DOJ has a number of criminal statutes that can be used to prosecute companies that knowingly profit from the use of forced labor. These include 18 USC 1581 (peonage), 18 USC 1584 (involuntary servitude), 18 USC 1589 (forced labor) and 18 USC 1590 (trafficking). Moreover, exploitation of forced labor often involves bribery of government officials, including health and safety inspectors, police and immigration authorities. As a result, a forced labor violation is also likely to trigger an FCPA investigation.

Companies can mitigate these risks through (1) supply chain risk assessments; (2) due diligence on suppliers and labor agencies; (3) on-site audits of manufacturing locations; and (4) requiring labor suppliers to sign and abide by codes of conduct that oblige them to comply with all applicable labor and employment laws, to treat workers with dignity and respect, and to ensure that all workers are over the age of 16 and meet all minimum age requirements.

6. Combating Counterfeit Production and Related Corruption Risks

Counterfeiting of luxury goods is a serious problem for the industry. Counterfeit goods are often produced in developing countries where the costs of manufacturing are low and enforcement of intellectual property rights is weak. They are then sold locally or shipped to developed markets (often with the assistance of false shipping and customs documents). In many developing countries, enforcement of anti-counterfeiting laws is a low priority for law enforcement, either because they lack resources and have more pressing issues to address or because they have been paid by the counterfeiters to look the other way. In some cases, law enforcement actually runs the counterfeiting industry.

Combating counterfeiting requires attacking it at its source. To this end, some companies have made payments to local police to incentivize more aggressive enforcement. Such payments may well attract the attention of DOJ and SEC and foreign authorities. Therefore, they should be made only with extreme caution, and only after a thorough analysis of all the relevant factors, to make sure that they comply with the FCPA and all applicable local laws.

FCPA Opinion Procedure Release No. 06-01 (16 October 2006) addresses this situation. In that case, the requesting company (the requestor) sought approval from DOJ to contribute US$25,000 to a pilot "incentive program" that would pay customs officers in an African country for seizing counterfeit products. The program was proposed to be funded by a group of companies, including the requestor, whose counterfeit goods passed through the African country. The requestor explained that lack of enforcement was a serious problem in the country, partly because customs officials received a percentage of the transit tax levied on all goods passing through the country, thus giving them a financial incentive not to interfere with any shipments.

DOJ agreed not to take any action and specifically noted the following facts as central to its decision:

The requestor agreed to enter into a memorandum of understanding (MOU) with the relevant government agency. The MOU was designed to:

- *encourage the mutual exchange of information related to the trade of counterfeit products bearing the trademarks of the Requestor and its competitors;*
- *establish procedures for an incentive compensation fund for the payment of awards to local Customs officials who detain, seize and destroy counterfeit products ("Award Candidates");*
- *establish eligibility criteria for the calculation of awards and the methods and frequency of distribution; and*
- *provide that the awards be given to Award Candidates directly by the Counterparty or given to local customs offices to distribute to their qualified Award Candidates.*

In addition, the requestor agreed to notify the Ministry of Justice of the program and verify the program's compliance with local law. Perhaps most importantly, it agreed to the following procedural safeguards:

- *First, the Requestor will make its contribution to the incentive compensation fund by electronic transfer to an official government bank account in the African country controlled by and in the name of the Counterparty, and will require written confirmation that the account is a valid government account, subject to periodic internal audit by the relevant government authorities.*
- *Second, the Requestor will be notified, upon a seizure of suspected counterfeit items by local customs officials, and will examine the suspect goods to confirm they are in fact counterfeit. The Requestor further represents that payments to Award Candidates will not be distributed unless and until destruction of the counterfeit goods is confirmed by delivery of a destruction certificate to the Counterparty (a copy of which would be sent to the Requestor).*
- *Third, the Requestor will have no part in choosing the Award Candidates, and the Counterparty will have sole control over, and full responsibility for, the appropriate distribution of funds. The Requestor, however, will require written evidence that its entire contribution was used only to pay identified Award Candidates and that the awards were based upon a predetermined award eligibility criteria and calculation method.*

- *Fourth, the Requestor will monitor the efficacy of the incentive program and discuss with the Counterparty during periodic reviews whether changes or refinements are necessary. As part of its monitoring effort, the Requestor will monitor the number of notices received from local Customs officials relating to relevant seizures during each six-month period and follow the progression of such seizures.*
- *Fifth, the Requestor will require as part of its MOU with the Counterparty that the Counterparty will retain for five years the records of the distribution and receipt of funds, and shall permit inspection of such records by the Requestor upon request during the life of the pilot project and for three years thereafter.*

The requestor also explained that its pending business in the African country was relatively small and "unrelated to the current request" and further stated that its future business was in no way dependent on the program. It also represented that its contribution was not intended to influence any foreign official to help it retain or obtain business and stated that, if the program were successful, it would continue to make contributions on an as-needed basis and would also encourage its competitors to do so.

Like all DOJ opinion releases, 06-01 is limited to its specific facts. However, it shows that companies can make incentive payments to law enforcement without violating the FCPA if they design safeguards sufficient to ensure that the payments will not be misused, and will not give them an improper advantage in obtaining or retaining business. As always, there is no "one size fits all" and, in order to pass muster under the FCPA, the safeguards must be context-specific and appropriate to the risks of the particular case.

IV. Corporate Compliance Programs as a Tool to Address Anti-corruption Risks

Corporate compliance is the system of self-governance established by a company to conform the conduct of its directors, officers, employees and business partners to the demands of the laws and regulations that govern the company's operations. The goal of compliance programs is to prevent and detect conduct that may violate these laws and regulations, allowing companies to govern themselves effectively. Companies in the luxury and fashion industry, and especially those with operations in emerging markets, should have compliance programs suited to protecting themselves from violations of applicable anti-corruption laws.

A well-designed compliance program that effectively manages a company's risks of violating the various legal and regulatory obligations it faces is a determining factor in the decision of whether to bring an enforcement action against a company when it violates any of these laws or regulations. In particular, with respect to enforcement of the FCPA, DOJ and SEC have said that "in appropriate circumstances," they "may decline to pursue charges against a company based on the company's effective compliance program, or may otherwise seek to reward a company for its program," even if the program fails to prevent the very violations it was designed to prevent. Outside the U.S., the importance of effective compliance programs is recognized by legislation of several countries. Examples include the UK Bribery Act, Brazil's recently enacted Clean Companies Act of 2013 and Italian Legislative Decree No. 231 of 2001, which provide for consideration of a company's compliance program when assessing whether to bring enforcement actions against a corporation. Thus, when a company demonstrates its commitment to meeting its legal and regulatory obligations by putting in place an effective compliance program, it may avoid an enforcement action, or mitigate any criminal or administrative fines, if an enforcement agency comes knocking at its door.

A. Global Standards for Corporate Compliance

Despite the clear benefits of implementing an effective compliance program, many companies, including companies in the luxury and fashion industry, struggle to understand and implement the rules, policies and protocols that should be in place to meet the expectations of enforcement authorities in the countries in which they operate. For companies focused on managing their anti-corruption risks, there now exists a complex, global regulatory framework to be navigated, as countries enact and enforce new and robust anti-corruption legislation put in place to meet rising global enforcement expectations.

The gold standard for compliance program best practices was once contained in the Sentencing Guidelines' "Seven Elements of an Effective Compliance Program," originally published in 1991. In the years since that publication, U.S. enforcement officials have established – and continue to refine, based on their enforcement experiences – a best practices framework for the design and implementation of compliance programs. In addition, other countries and global anti-corruption standard-setting organizations have also established anti-corruption compliance program expectations. In order to understand better the components of an anti-corruption compliance program that meets the legal and regulatory requirements of enforcement agencies throughout the world, the compliance requirements of key anti-corruption laws around the globe are reviewed below.

1. The Sentencing Guidelines and the General Framework of a Compliance Program

Although anti-corruption laws are now aggressively enforced throughout the world, global enforcement standards are generally derivative of FCPA enforcement, which has served as a standard bearer for global enforcement standards. Accordingly, U.S. sentencing practices and compliance program considerations have similarly impacted the global understanding of those components necessary for an effective compliance program. U.S. compliance program expectations, including those surrounding the FCPA, are based on the Sentencing Guidelines. In 1991, the U.S. Sentencing Commission promulgated sentencing guidelines for business organizations, which instructed federal judges to impose significant monetary penalties on criminally convicted companies. Despite a 2005 US Supreme Court ruling concluding that judges are not bound by these guidelines when imposing sentences, they remain the most informative considerations for anticipating the consequences of an FCPA enforcement action against a company. As with all sentencing guidelines, the Sentencing Commission identified factors that would increase or reduce an organization's culpability. Among these factors is "the existence of an effective compliance and ethics program" (the others being self-reporting, cooperation and acceptance of responsibility). The Sentencing Commission went on to detail the seven components of what it viewed as an effective compliance program. These seven elements are described as the minimum requirements for establishing a compliance program that promotes an organizational culture of ethical conduct. Thus, they direct companies, at a minimum, to:

a. establish standards and procedures to prevent and detect criminal conduct;
b. ensure leaders understand and oversee the compliance program, in order to verify its effectiveness and the adequacy of support for the program, and that specific individuals are vested with the authority and responsibility to implement the program;
c. use reasonable efforts to deny leadership positions to people who have engaged in illegal activities or other misconduct;
d. periodically communicate the standards and procedures of the compliance program to employees and conduct effective training programs;
e. monitor and audit employee conduct, evaluate the effectiveness of the compliance program, and maintain reporting mechanisms for employees who become aware of misconduct;
f. provide incentives for employees to perform in accordance with the compliance program, and impose disciplinary measures against personnel who engage in criminal conduct; and
g. respond quickly to allegations of criminal conduct and modify aspects of the compliance program, if necessary.

The seventh requirement was clarified in an “Application Note” added by the Sentencing Commission. The note, part of 2010 amendments to the Sentencing Guidelines, lists specific steps that may be considered “reasonable” in responding to and preventing misconduct. Under the amendments, appropriate responses to finding wrongdoing may include providing victims with restitution, self-reporting, cooperating with authorities, and the assessment and potential modification of a company’s compliance and ethics program.

Another amendment gives corporations an incentive to create a direct line of communication between compliance personnel and the board of directors. In particular, it provides that if compliance personnel have “express authority” to communicate with the board about potential criminal misconduct “promptly,” as well as the status of the compliance program at least annually, a corporation found guilty of wrongdoing may still receive credit for having an effective compliance program, even if high-level personnel were involved.

Additional guidance on U.S. law enforcement’s expectations for an effective compliance program can be found in DOJ’s “Principles of Federal Prosecution of Business Organizations.” First issued in 1999, these principles serve as a guide for federal prosecutors when deciding whether to criminally charge a corporation for the misconduct of its employees. The fifth of these principles instructs prosecutors to consider whether the company attempted to prevent the wrongdoing through a well-designed and pre-existing compliance program. When read together, the Sentencing Guidelines and the principles underscore the importance of a compliance program, and provide guidance on compliance program minimum standards to which companies subject to U.S. legal and regulatory jurisdiction should adhere.

2. The “Hallmarks” of an Effective Anti-corruption Compliance Program under the Guidance

The publication of the guidance by SEC and DOJ in 2012 was a major development with respect to anti-corruption compliance program best practices. The guidance provides key advice on the “hallmarks” of an effective anti-corruption compliance program, and the best practices that DOJ and SEC expect companies to follow when addressing corruption risks. The guidance indicates that when assessing an anti-corruption compliance program, the agencies ask three key questions: (1) is the program well designed?; (2) is it applied in good faith?; and (3) does it work? The guidance warns against “paper tiger” programs, which are often accompanied by assurances of efficacy, but in practice fail to demonstrate program effectiveness. Having become more familiar with compliance program best practices, the agencies are more carefully reviewing the effectiveness of compliance programs. “Does it work?” is now a critical part of DOJ and SEC’s assessment of whether to reward a company for its compliance program, and companies are now expected to provide tangible proof in response to this question.

3. The OECD’s Good Practice Guidance on Internal Controls, Ethics and Compliance

Among the most significant global developments with respect to anti-corruption compliance programs was the release in 2010 of the OECD’s Good Practice Guidance.[30] Its purpose is to provide companies with instruction on best practices for establishing and ensuring the effectiveness of their internal controls, ethics and compliance programs. The good practice guidance advises that corporations adopt a compliance program that incorporates the following elements:

a. an internal controls and compliance program designed around a risk assessment;
b. an anti-corruption policy that clearly and visibly prohibits bribery;
c. periodic, documented training;
d. responsibility at all levels of the company for monitoring;
e. strong, explicit and visible support for the compliance program from senior management;
f. oversight of the compliance program by senior corporate officers who have sufficient resources, authority and access to the company’s board of directors;
g. promulgation and implementation of specific policies and procedures to address key risk areas and issues;
h. due diligence on business partners;
i. effective internal controls designed to ensure accurate books and records;
j. systems in place that provide advice in order to ensure adherence to the compliance program;
k. mechanisms in place to report confidentially violations of company policies and procedures without fear of retaliation;
l. discipline for violations of policy; and
m. regular review and assessment of the compliance program and implementation of necessary revisions.

These standards are considered global best practices, serving as key guidance especially for companies operating in countries that have recently enacted legislation to meet their obligations under the OECD Convention.

[30] The OECD’s list has 12 items but the introductory paragraph instructs that an effective ethics and compliance program must be built on the basis of a risk assessment, making it thirteenth element.

4. The UK Bribery Act's "Adequate Procedures"

The role of anti-corruption compliance programs as a defense to criminal charges is also acutely evident in the UK's Bribery Act of 2010. The act introduces, among other general offenses, a strict liability corporate offense where a relevant commercial organization fails to prevent a bribe being paid on its behalf by associated persons. It also establishes an affirmative defense from criminal prosecution of a company if a company can show that it has established "adequate procedures" for preventing bribery. Following the enactment of the UK Bribery Act, the UK Ministry of Justice, in 2011, published a guidance containing principles for "adequate procedures." The guidance concerning the act offers these six general principles of bribery prevention:

a. proportionate procedures that are clear, practical and accessible, and effectively implemented and enforced;
b. top-level commitment to preventing bribery, fostering a culture of compliance within the company;
c. risk assessments that are periodic, informed and documented;
d. due diligence procedures addressing third parties;
e. communication of policies and procedures (including training); and
f. regular monitoring and review of its procedures.

Although the OECD's Good Practice Guidance, the Ministry of Justice Guidance on the UK Bribery Act and the Sentencing Guidelines differ in the number of elements or principles for anti-corruption compliance programs, these elements and principles all fall within five key categories or issues that can be boiled down to five essential elements: leadership, risk assessment, standards and controls, training and communication, and oversight. As is discussed below, if a company's anti-corruption compliance program effectively covers these five essential elements, it will likely fulfill the wide variety of law enforcement expectations around the world and help prevent costly anti-corruption enforcement actions. In the event of a government investigation, a company with a robust anti-corruption compliance program that encompasses these five elements is much more likely to be granted compliance credit, a reduction in penalties, and other forms of leniency that could ultimately minimize damages.

B. Five Essential Elements of an Effective FCPA Corporate Compliance Program

Developing and maintaining a strong corporate compliance program can be challenging, especially for companies operating in multiple countries, because they face an increasingly complex network of anti-corruption enforcement regimes. Furthermore, government authorities around the world are steadily raising expectations with respect to the comprehensiveness of corporate compliance programs, demanding robust policies, procedures and controls that address the full scope of regulatory risks faced by companies. Effectively managing corporate compliance efforts, while operating in a highly competitive environment with thousands of employees, multiple business partners, and extensive global operations including in emerging markets, can be challenging for multinational companies in the luxury and fashion industry.

As discussed in detail above, although enforcement guidelines around the world vary in length, tone, and language, virtually all touch upon a set of key issues and themes that can be reduced to five essential elements: leadership, risk assessment, standards and controls, training and communication, and oversight (monitoring, auditing and response).

If a company's compliance program effectively covers these five elements, it will likely meet the wide variety of law enforcement expectations around the world for maintaining a successful compliance program. Further, global enforcement standards are largely derivative of the FCPA model. Thus, an anti-corruption compliance program that is designed to meet the high expectations of U.S. enforcement officials will normally be sufficient from a global perspective. Accordingly, below is a brief analysis of each element and specific actions a company can take to ensure it is fulfilling the requirement of each element. Although these best practices should guide a company in developing its compliance program, there is no one-size-fits-all compliance program, and enforcement officials will expect a compliance program to address the unique risks and circumstances of an individual company.

1. Leadership

Enforcement officials expect that, at a minimum, an effective compliance program will be built on a strong foundation of ethics that is fully endorsed by senior management and includes an internal structure designed to support the compliance program and, further, a culture of compliance. The guidance emphasizes the key role of leadership in establishing an effective compliance program. According to the guidance, an effective compliance program begins with senior management clearly articulating and communicating company standards, adhering to them scrupulously and disseminating them throughout the organization. As the agencies state, "a compliance program should apply from the board room to the supply room – no one should be beyond its reach." The DOJ and SEC will thus consider whether, when enforcing a compliance program, a company has appropriate and clear disciplinary procedures, whether those procedures are applied reliably and promptly, and whether they are commensurate with the violation."

a. Senior Leadership

Further, a compliance program that meets enforcement expectations will ensure that accountability for the success of the program rests with high-level leadership at the company. Senior executives should be assigned responsibility for the oversight and implementation of the compliance program, and "have appropriate authority within the organization, adequate autonomy from management, and sufficient resources to ensure that the company's compliance program is implemented effectively." "Adequate autonomy," according to the agencies, "generally includes direct access to an organization's governing authority, such as the board of directors and committees of the board of directors (e.g., the audit committee)."

b. Adequate Resources

Additionally, "in assessing whether a company has reasonable internal controls, the DOJ and SEC typically consider whether the company devoted adequate staffing and resources to the compliance program given the size, structure, and risk profile of the business." Based on the agencies' pronouncements, it should not be in doubt that an effective corporate compliance program must have strong leadership, support and engagement from senior management. However, compliance standards require more than support from the top. In order to meet government expectations, a compliance program should be led by high-ranking, independent compliance officers, empowered with the authority and resources to manage the program on a day-to-day basis. In particular, a company should appoint a chief compliance officer (CCO) with the ability, authority and resources to manage compliance initiatives.

c. Board-level Accountability

A key element of a successful compliance program is board-level accountability for the effectiveness of the program, accomplished by vesting the board of directors itself with responsibility for developing and maintaining a culture of compliance. Robust compliance programs require those responsible for the effective operations of the company to ensure that appropriate operational systems and corporate structures are in place to enable the company to operate in a compliant manner. Thus, a CCO should report at least annually to the board of directors on the implementation and effectiveness of the company's compliance program. Further, board members should receive regular and timely compliance training on compliance and risk management trends, so that they are in the best position to steer the company away from potential misconduct. Finally, any matter involving criminal conduct should be promptly reported directly to the board, or appropriate board committee, for further assessment and handling.

d. Communication

To be effective, corporate anti-corruption compliance policies and procedures must be embraced by personnel throughout an organization. To this end, a company must establish a "tone at the top" that prioritizes compliance and empowers the company's compliance function. Leadership must educate and motivate personnel at all levels, and incorporate third parties that serve the company (agents, representatives, consultants, joint venture partners and others) into the culture of compliance.

One of the biggest impediments to effective compliance leadership is poor communication between a company's central compliance department and regional or country managers working in the field. Yet, those managers and their employees in the field are on the front lines of the corruption risks faced by a company. Thus, it is advisable for a multinational company to appoint regional compliance officers capable of managing compliance efforts in their respective locations. The central compliance department must communicate with and train country managers, to ensure they set the correct tone for compliance, and detect and address illegal or unethical practices before they become compliance issues. A company should also consider placing well-trained compliance personnel in its higher-risk foreign offices, to ensure the compliance program is effectively implemented in those offices facing the greatest corruption risks.

2. Risk Assessment

As companies in the luxury and fashion industry have expanded their enterprises and become more dependent on global supply chains, knowing and understanding the nature and extent of business risks has become a critical first step for implementing successful compliance programs. In fact, enforcement officials expect a company to implement a compliance program that is based on a thorough understanding of the corruption risks it faces everywhere it does business (particularly in higher-risk regions, including emerging markets, such as China, Russia, India and Brazil) to ensure that its compliance program is designed and effectively implemented to address the actual corruption risks presented by its operations and business partners. As the guidance states, the "[a]ssessment of risk is fundamental to developing a strong compliance program, and is another factor [the] DOJ and SEC evaluate when assessing a company's compliance program." The regular evaluation of a company's risks – its interactions with government officials, use of third-party agents and intermediaries, the regulatory environment in which it operates, and any strategic business developments – will provide a company with an understanding of the anti-corruption risks it faces, allowing it more effectively to design and implement a compliance program that directly addresses those risks. In RLC's 2013 settlement with DOJ and SEC, the company was praised for uncovering the inappropriate conduct during an internal review. George S. Canellos, Acting Director of SEC's Division of Enforcement, stated that "[w]hen they found a problem, Ralph Lauren Corporation did the right thing by immediately reporting it to the SEC and providing exceptional assistance in our investigation."

a. Risk Assessment Process

When conducting a risk assessment, a company should review its structure and locations, joint ventures, corporate affiliations, expansions into higher-risk markets, business practices, industry sector, client base, third-party intermediary engagements, policies and procedures, systems and controls, training protocols, audit reports, compliance monitoring and the regulatory environment of the regions where the company operates. A best practice risk assessment will also identify key stakeholders, and capture information about areas of concern and opportunities for enhancement.

Once risks are known, weighted recommendations can be developed, to prioritize allocation of resources and effectively address compliance risk areas by country. A company should memorialize risk assessment findings in a report that is presented to the compliance officer and board of directors for review and consideration. As a company develops its compliance program based on a risk assessment, it should also document the enhancements and their relationship to the risk assessment findings.

b. Periodic Assessments

A company should conduct periodic risk assessments, as anti-corruption enforcement trends and corporate practices evolve rapidly, to ensure its compliance program remains responsive to the highest risks, and update anti-corruption policies and procedures accordingly. A company operating in or entering higher-risk markets, or with rapidly evolving risk profiles, should consider conducting annual risk assessments, to ensure its compliance program does not become stale.

3. Standards and Controls

It is no longer in question that a company should have a code of business conduct. Through its code of business conduct, a company sets forth its core values and establishes a foundation for its compliance culture. A company without one will present a clear red flag to enforcement officials that it lacks the basic internal controls expected of both publicly and privately held companies. A best practice code will expressly prohibit bribery, and otherwise be "clear, concise, and accessible to all employees and to those conducting business on the company's behalf." Further, enforcement officials expect a company to update and maintain its code. As the guidance states, "when assessing a compliance program, the DOJ and SEC will review whether the company has taken steps to make certain that the code of conduct remains current and effective and whether a company has periodically reviewed and updated its code."

a. Detailed Anti-corruption Policies and Procedures

Today, best practice requires a company to use more than just a code of business conduct to manage employee conduct. Compliance standards now require a company to have comprehensive, detailed written anti-corruption policies in place that are supported by clear procedures and protocols to ensure their implementation. The guidance is instructive on the types of anti-corruption risks a company's policies and procedures should address: "among the risks that a company may need to address include the nature and extent of transactions with foreign governments, including payments to foreign officials; use of third parties; gifts, travel, and entertainment expenses; charitable and political donations; and facilitating and expediting payments." Thus, a company should have in place policies and procedures that address the following high-risk areas: interactions with government officials; interactions with government and private customers; the retention and oversight of business partners, including third-party intermediaries or those acting for or on the company's behalf; facilitation payments; acquisitions and joint ventures; gifts, travel, hospitality and entertainment; political contributions; charitable donations and sponsorships; books and records; training; whistleblower reports; and investigation and remediation.

b. Third-party Protocols

It is also now expected that a company will have in place stringent protocols for the review and screening of business partners and third parties. Over 80 percent of anti-corruption enforcement actions across the globe involve the use of third-party business partners to facilitate improper conduct. Thus, DOJ and SEC state, "risk-based due diligence is particularly important with third parties and will also be considered by DOJ and SEC in assessing the effectiveness of a company's compliance program." Generally speaking, this review should determine, among other things: (1) whether or not an individual proposing to serve the company in exchange for payment is a government official; (2) whether or not an entity employs a government official, or is a company in which a government official has an ownership interest or serves on the board of directors; (3) whether the services the individual or entity is being put forward to perform are necessary to further an existing business initiative or contract; (4) whether the individual or entity has the expertise, experience and other qualifications to perform the necessary services in a legitimate fashion; and (5) whether or not the individual or entity is likely to engage in practices that could expose the company to liability. Any red flags identified during this due diligence process should be sufficiently investigated, to enable a company to obtain accurate information regarding the above factors and reasonably assess the risks of doing business with the entity.

A company should also be sure that contracts with all business partners include compliance covenants that require the intermediary to adhere to the FCPA and international anti-corruption laws, and provide for audit and contract termination rights, and that higher-risk business partners, such as third-party intermediaries, be required to adhere to certain, additional, covenants specifically addressing the risks of the particular engagement.

c. Additional Procedures

A company should also provide clear guidelines and protocols for gift giving and hospitality, political donations and charitable contributions, designed to ensure that none are used to facilitate an improper payment. Finally, enforcement officials will expect a company to have in place "policies and procedures that outline responsibilities for compliance within the company, detail proper internal controls, auditing practices, and documentation polices, and set forth disciplinary procedures." Thus, a company should establish internal controls to ensure accounting records are accurate. Although the particular accounting controls will vary, depending on an organization's size, foreign presence, risk profile and resources, they generally should include processes that: allow transactions to proceed only after appropriate management authorization; require accurate documentation of all transactions in fair and reasonable detail for accurate financial statements; provide for access to assets only with management authorization, including properly delegated authority to independent individuals for expense approval; and ensure accountability for company assets. Finance and accounts payable staff should receive specialized anti-corruption training to ensure they are able to identify suspicious transactions.

The SEC order in the Smith & Wesson FCPA enforcement action illustrates the importance of effective controls: "While the company had a basic corporate policy prohibiting the payment of bribes, it failed to implement a reasonable system of controls to effectuate that policy. For example, Smith & Wesson failed to devise adequate policies and procedures with regard to commission payments, the use of samples for test and evaluation, gifts, and commission advances. Further, Smith & Wesson's FCPA policies and procedures, and its FCPA-related training and supervision were inadequate." Though Smith & Wesson had some policies in place, they were not adequate or effective.

4. Training

A key factor in successfully implementing an anti-corruption compliance program is the incorporation of an effective training program. Enforcement agencies expect a company to ensure that "relevant policies and procedures have been communicated throughout the organization, including through periodic training and certification for all directors, officers, relevant employees, and, where appropriate, agents and business partners." In order to effectuate this, a company should develop an annual, risk-based training plan that addresses the delivery of live and computer-based anti-corruption training to company officers, employees and third parties. As part of its commitment to its anti-corruption compliance, a company must be willing to provide the resources necessary to communicate these messages throughout the organization. The peril of failing to implement an effective training program was highlighted by RLC's recent settlement of an FCPA enforcement action. During the years that the manager of RLC's subsidiary in Argentina bribed customs officials in Argentina, RLC had no anti-corruption training or oversight with respect to its subsidiary in Argentina.

a. Prioritized Training

A company should prioritize training for country managers; employees in high-risk markets; and directors, officers and sales employees who have contact with government officials or state-owned entities. If resources permit, a company should provide in-person compliance training for country managers yearly. A company should also conduct in-person annual training in the high-risk markets where they operate. In-person training is the enforcement officials' preferred method, but live videoconferences and webinars with question-and-answer sessions are a good alternative if resources are limited.

b. Tailored and Documented Training

Training should be tailored to address the challenges an employee faces in his or her role and country, and should cover the FCPA, UK Bribery Act, OECD guidelines and local anti-corruption laws. Additionally, training should be updated regularly, to reflect changing anti-corruption laws and enforcement trends. All training efforts should be thoroughly documented. Certifications and attendance records show that employees received and acknowledged understanding of the company's anti-corruption policies.

5. Oversight – Monitoring, Auditing and Response

It is not enough to put in place anti-corruption policies and procedures. A company must ensure that these policies and protocols are being followed and that the compliance program works. FCPA settlement agreements direct companies to oversee, monitor, and test their compliance programs through "periodic reviews and testing" designed to "evaluate and improve their effectiveness in preventing and detecting violations of anti-corruption laws." A company's failure to do so will be viewed by enforcement authorities as an indication of a "paper tiger" compliance program – a compliance program that, although strong on paper, is ineffective, as a result of the company's failure to implement it in good faith, and regularly monitor and test it to ensure its effectiveness. As noted in the FCPA guidance, "compliance programs that do not just exist on paper but are followed in practice will inevitably uncover compliance weaknesses and require enhancements;" thus, companies are instructed to "take the time to review and test" their controls and "think critically" about "potential resources and risk areas." The 2011 SEC settlement involving premium alcoholic beverage producer Diageo plc makes clear the importance of effective controls and continuing oversight. Scott W. Friestad, Associate Director of the SEC's Division of Enforcement, stated that, "[a]s a result of Diageo's lax oversight and deficient controls, the subsidiaries routinely used third parties, inflated invoices, and other deceptive devices to disguise the true nature of the payments."

a. Continuous Oversight

An effective compliance program incorporates continuous oversight, in the form of real-time monitoring, risk-based auditing, and testing of internal controls, and the timely response to allegations of misconduct. Monitoring and auditing functions are related, but serve separate purposes within an effective compliance program. While monitoring involves the real-time review of a company's transactions and business partners, an audit is a more limited review, which, going back in time, targets a specific business component or region, to evaluate transactions and business partner relationships for anti-corruption risks or red flags.

A company should establish a regular monitoring system, tailored to its specific risks, to review the compliance programs on an ongoing basis. Regional business directors should keep tabs on the activities and areas where the risk of potentially improper activity is high in the countries they manage, and the compliance department should discuss and address these issues as they arise. During compliance training, company representatives should pay attention to comments or questions that may raise "red flags," and address any issues that arise. Additionally, senior executives and managers should produce regular monitoring and auditing reports that reflect a good faith application of the compliance program. Per the guidance, "[u]ndertaking proactive evaluations before a problem strikes can lower the applicable penalty range under the US Sentencing Guidelines."

b. Investigative Protocols

Protocols for internal investigations and disciplinary action should be established in advance, to allow for a swift response to compliance issues. Investigative protocols should address document preservation, data privacy issues, and communications systems designed to manage information. When potential misconduct is discovered, a company must react quickly, gather information, and respond effectively to address and remediate the problem. This includes establishing disciplinary policies that clearly state how to address misconduct. A company should also act quickly to remediate any issues discovered, including closing gaps in training or enhancing existing controls. A company's oversight of the compliance program should ensure that any indication of misconduct is elevated and addressed appropriately. The guidance affirms that "[a]n effective compliance program should include a mechanism for an organization's employees and others to report suspected or actual misconduct or violations of the company's policies on a confidential basis and without fear of retaliation."

V. International Developments

Outside of the U.S., anti-corruption enforcement has historically been less robust. However, in the last several years, the fight against corruption has been rapidly gaining momentum around the world. In particular, three trends have emerged.

First, a growing number of countries have adopted, and continue to adopt, stricter and more expansive anti-corruption laws. For the signatories of the OECD Convention, this is a direct result of their obligations under the convention and peer pressure from the OECD Working Group. The UK Bribery Act, arguably the most expansive anti-corruption law, was adopted by the UK after significant criticism from the OECD Working Group. Italy and France followed suit, with introduction of heavier sanctions, expansion of corruption offenses, and, in France, the introduction of a new prosecution authority. China, Brazil and Mexico, on the other hand, recently introduced tougher anti-corruption laws in response to internal pressures, to address growing concerns from domestic constituencies. Other notable recent development includes the enactment in India, in January 2014, of the Lokpal and Lokayuktas Act, 2013, which creates a new anti-corruption agency responsible for investigating corruption in India.

Second, there has been an increase in anti-corruption prosecutions. China has ramped up its enforcement activities, including through the active pursuit of corruption cases against government and Communist Party officials of all ranks, and executives of large, state-owned enterprises; as well as of violations of commercial bribery laws. Today, China and the U.S. appear to be making the most significant enforcement efforts. Brazil has also seen a dramatic increase in corruption cases. The numbers are less impressive in countries like the UK, Italy and France, but there has been progress and more cases are reported to be in the pipeline.

Another growing trend is recognition of the importance of compliance programs as a tool to prevent and detect misconduct. For instance, in the UK and Italy, anti-corruption legislation provides that companies may avoid liability for corruption offenses. Russia amended its Criminal Code in 2013, to impose an affirmative obligation on companies that operate in Russia to establish anti-corruption compliance programs. In countries like Brazil, the enforcement authorities reward companies that have working compliance programs, by applying lighter sanctions or by declining to bring an action.

In this section, we cover recent developments in Russia, the UK, Italy and France, for Europe, the Middle East and Africa; Brazil and Mexico, for the Americas; and India and China, for the Asia Pacific. For Russia and India, we provide an analysis of the risks facing the luxury and fashion industry, and recommendations on how to manage such risks. For the other countries, we focus on recent legislative developments and enforcement trends.

A. Europe, The Middle East and Africa

1. Russia

Political events in the region have had a negative effect on many sectors of the Russian economy, leading to nearly universal predictions of recession in the coming years. The long-term effects on the luxury goods market may be assumed to be negative, with the ruble dramatically declining in value, relative to the euro and the U.S. dollar, since the fall in oil prices that began last summer. The pain inflicted on the Russian budget resulting from the fall in oil prices and the contraction in the Russian economy as a whole will only increase pressure on revenue-generating government authorities to add to their income. Tax, customs and other administrative authorities are, and will continue to be, under pressure from the Kremlin to boost their contributions to regional and federal budgets. The increased pressure will only add to the risk that such authorities will demand improper payments.

a. Customs

As with its counterparts in other emerging markets, Russia's Federal Customs Service is notorious for extracting illicit payments from companies engaged in the importation of goods, and its officials are particularly attuned to the luxury goods market. High import duties and excise taxes on luxury goods lead importers to engage in any number of schemes meant to understate the value of imported goods or to misstate the nature of the goods themselves. Customs officers know this, and may demand high payments to overlook, or even to facilitate, such schemes, leading to risks of liability under anti-corruption laws for those making or approving such bribes.

Even where goods are declared properly and transparently, importers face a number of challenges that incentivize them to cut corners, taking risks that they may come to believe must be papered over with bribes. The exorbitant costs associated with importing a container of goods – already approaching US$3,000,[31] not including customs duties and import taxes – provide strong incentives for Russian importers to take measures to cut corners in any way possible. Russia's customs laws and regulations are notoriously complex, with at least a dozen forms required for importation. Completion of the forms, inspections and customs clearance may take two to three weeks, and arbitrary inspections, demands for corrections to paperwork, and the risk of placement of a truck in a "customs convoy" may further delay the arrival of goods at their destination. Russian customs officers have broad latitude to expedite or delay these processes, and this discretion is a key driver of demands for illicit payments.

Law enforcement officials in the U.S., Russia and elsewhere are knowledgeable about corruption within Russia's Federal Customs Service. A number of enforcement actions, including at least one of the highest-value resolutions in the history of FCPA enforcement, have directly involved companies charged with making or approving improper payments to Russian customs officers. Companies importing goods into Russia are therefore advised to monitor closely how their products enter the country. Regardless of whether the manufacturer or a third-party distributor or agent is responsible for retaining and directly supervising the customs brokers, freight forwarders, or other service providers charged with getting products over the Russian border, the manufacturer selling the goods is ultimately responsible for how its goods get to market. If bribes are greasing the way through customs, the manufacturer's risk of facing liability can be substantial.

b. Tax and Other Inspections

Russian companies face frequent inspections – or *proverki* in Russian – from a wide array of officials, from health and safety, to fire, labor and tax authorities. No less than their counterparts in the customs service, the Russian tax authorities face tremendous pressure from Moscow to increase tax receipts. Other federal, regional and municipal agencies likewise face declining budgets, and may use inspections as a means of extracting payments from companies doing business in their respective jurisdictions. And while tax authorities and other agencies may exploit these opportunities to support their budgets, individual officials, too, may view inspections as opportunities to enrich themselves personally. Wealthy foreign companies are a primary target, so those selling luxury goods in Russia must be extremely careful in their interactions with Russian officials.

Tax inspections are generally the most intrusive ones and carry the highest stakes of the various *proverki* that a company may face. Companies face both planned inspections and spontaneous inspections that may be initiated at the discretion of the relevant tax authorities. Tax inspectors may run an inspection from within a company's offices for weeks, or even months, at a

[31] World Bank Group, "Doing Business in Russia," available at http://www.doingbusiness.org/data/exploreeconomies/Russia.

time, with the authority to request years of sales records and other financial documentation. The slightest discrepancy in supporting documentation for a given transaction may give rise to substantial fines, interest and other penalties. Companies seeking to shorten the length of the inspection – or to resolve issues raised along the way – may feel pressure to make illicit payments to the tax officials behind the inspections.

Worse, inspectors may hand over the results of their audits to criminal prosecutors, who may charge high-ranking officers – typically, the general director and chief accountant (CFO) – with criminal tax evasion or fraud. Facing jail time for their employees, companies, not surprisingly, often pay substantial bribes, usually through criminal lawyers (*advokaty*) or other consultants recommended by the prosecutors, to have the charges reduced or dismissed altogether.

Although such unwanted attention is not unique to the luxury goods market, manufacturers, distributors, retailers, and others dealing in luxury goods, are easy targets, as the above-described incentives to minimize taxes and duties – and thereby to falsify documents used to prepare tax filings – all come together to form a nexus of risk that must be managed extremely carefully.

c. De-offshorization

Corruption in all forms in Russia makes use of offshore shell companies to move money to the ‘right people’ – the bribe recipients, who, if not paid, could hinder the normal conduct of business. Where once bribes could be paid by envelopes or suitcases full of cash, today’s more sophisticated market requires that illicit payments pass the increasingly strict internal accounting controls imposed by companies subject to the FCPA, the UK Bribery Act, and, increasingly, Russian anti-corruption law. Furthermore, any such payments would have to be disguised, to avoid detection by the tax inspectors (see above), who would be sure to question large inflows or outflows of cash.

Companies selling into Russia are frequently asked to sell not to their Russian partners – whether local distributors, resellers, or the companies’ own Russian subsidiaries or affiliates – but to offshore, third-party entities involved for one reason or another in the transaction by the Russian side. Because of the above-described pressures to reduce customs duties and import taxes, particularly in the luxury goods arena, many companies operating in Russia have historically turned to complex offshore/onshore sales structures to minimize these expenses.

While the schemes may be as varied and as complex as can be imagined, they typically involve a sale to an offshore entity nominated by a friendly bank that manages a stable of such companies for its clients’ convenience. That entity then sells to a Russian entity inside Russia – often another shell company (*odnodnevka*) – that manages the customs clearance and other importation procedures. This company may sell to one or more additional shell companies before finally selling the goods to the Russian distributor, reseller, or other partner of the original manufacturer. Some substantial portion of the profits along the way would typically be left with one of the shell companies, which would be liquidated, along with its tax arrears, after making the necessary distributions of funds as illicit payments to the right people.

Risks to the foreign manufacturer vary, depending on the nature of the company’s knowledge of, and involvement in, any illegal tax-evasion scheme. Under Russian law, it is typically the onshore distributor or other partner that would face the real risk of legal liability, unless the foreign partner or its onshore affiliates could be proved to have been involved in establishing or otherwise organizing the illegal scheme. Even where the risk of liability lies solely with the onshore partner, the manufacturer risks disruption and unwanted scrutiny of its distribution network in Russia. To the extent problems are smoothed over through illicit payments, the manufacturer risks liability under applicable anti-corruption laws, including Russian law, and the FCPA and the UK Bribery Act.

In response to the years of abuse of such offshore entities, Russia recently passed the so-called "De-offshorization Law."[32] Under this law, companies will no longer be able to shield from taxation income earned by offshore companies owned or otherwise controlled by Russian taxpayers (whether individuals or entities). Although a detailed description of the De-offshorization Law is beyond the scope of this chapter, the impact of the law on manufacturers of luxury goods may be profound, as importers revise their importation schemes and otherwise reconsider the way they structure sales, as the new law makes the old structures riskier and less useful in terms of tax savings.

d. Managing These and Other Corruption Risks When Doing Business in Russia

Although a full overview of anti-corruption due diligence is beyond the scope of this chapter, there are a few points to consider when undertaking due diligence on a prospective Russian counterparty. The first priority is to understand the legitimate commercial purpose and qualifications of the counterparty in question. Does the counterparty have a real role to play in the transaction and, if so, is the counterparty actually qualified – in terms of experience, personnel and other resources – to perform the required tasks? The use of shell companies serving no legitimate purpose in a transaction – or companies that are unqualified or otherwise unable to perform the required services – to pay bribes remains commonplace, so it is important to ensure that any company involved in your business in Russia, including in the supply chain, actually belongs there.

Second, it is important to understand who benefits financially from all business relationships. As noted above, it is frequently the case that government officials, or individuals associated with such officials, will have hidden ownership in companies, particularly through onshore and offshore shell companies, so even a legitimate service provider may be used as a means of funneling money to government officials. Where the service provider's role in the transaction is suspect in the first place, this risk increases exponentially. Russian companies frequently balk at requests to disclose their ultimate beneficial ownership, so companies should consider carefully whether they are willing to assume the risk of dealing with a counterparty that refuses to disclose its true beneficiaries and ownership structure. The reasonable, prudent course is to take a risk-based approach, insisting on such disclosure for the closest, highest-value business relationships and considering lower-risk transactions and relationships accordingly.

Third, companies should maintain careful oversight over their business partners – again, to a reasonable degree, depending on the facts and circumstances, and attendant risks, of the relationship in question – for the duration of the relationship. Passing due diligence is a critical stage, but risks do not disappear once a contract is signed. If corruption red flags emerge during the course of the relationship, they must be resolved promptly, to avoid incurring liability.

[32] Federal Law No. 376-FZ, "On Amendments to Parts One and Two of the Tax Code of the Russian Federation (Regarding the Taxation of the Profit of Controlled Foreign Companies and the Income of Foreign Organizations."

Companies should consider carefully whether or not to demand audit rights to review the counterparty's financial books and records, and supporting documentation relating to the relationship. As with the ownership disclosure described above, many Russian companies will resist a request for fulsome audit rights. Although not every relationship demands full audit rights, companies should consider pressing for such rights – and exercising such rights where red flags appear – for those relationships that are likely to pose the greatest risks.

2. UK

a. Legislative Developments

The UK Bribery Act came into force in July 2011, and became a key part of a new global wave of robust anti-corruption legislation, with the promise of a marked increase in enforcement. Since it was adopted, there has yet to occur the volume and profile of UK Bribery Act enforcement that some had predicted.

There are a number of factors that may help to explain the relatively limited enforcement activity to date under the UK Bribery Act. First, UK Bribery Act charges can only be brought related to conduct that occurred after the act came into force. The length of time that it takes to properly investigate and prosecute these complex cases inevitably results in a long pipeline of matters, which date back several years. In comparison, the facts that give rise to a significant percentage of recent FCPA settlements date back years and sometimes decades – often long before the UK Bribery Act came into force.

Second, until recently, SFO, the UK agency that currently has primary responsibility for investigating and prosecuting significant financial crime and bribery, has not had the same armory of enforcement tools that is available to its U.S. counterparts. However, for the first time, from February 2014, deferred prosecution agreements are now available to UK prosecutors. Among other things, these can help facilitate the relatively efficient settlement of corporate enforcement cases, including those brought under the UK Bribery Act. The extent to which UK prosecutors will use such agreements to resolve corruption cases, as their U.S. counterparts have done, remains to be seen, however.

Third, although FCPA enforcement is driven, at least in part, by a well-established, and widely used, regime for corporate voluntary disclosure of corruption issues, the potential benefits for companies using the analogous UK voluntary disclosure regime, introduced in conjunction with the UK Bribery Act, are yet to be fully tested.

In addition to the introduction of deferred prosecution agreements, the UK government and anti-corruption enforcement agencies have taken a number of additional steps to coordinate and bolster their approach to anti-corruption enforcement. These include the introduction of new sentencing guidelines for bribery, fraud and money laundering (including corporate offenses) that came into effect on 1 October 2014. Additionally, in December 2014, the UK government published an "Anti-Corruption Plan" that outlines the UK's strategic approach to combating domestic and foreign corruption. The plan envisions increased anti-corruption prosecution, but also includes discussion of the UK anti-money laundering and asset recovery mechanisms as a tool in combating corruption and its perpetrators. These powers include the ability to freeze, seize and recover assets (including, e.g., luxury goods) that may represent criminal proceeds of bribery or represent part of a "criminal lifestyle."

b. Enforcement Trends

Although there has not yet been an enforcement of a case involving the luxury and fashion industry, there have been an increasing number of UK Bribery Act charges and convictions. These cases are profiled below, to demonstrate SFO's enforcement activities. Most recently, in December 2014, three men were convicted of various fraud and corruption offenses (including under the UK Bribery Act), following a SFO investigation into a complex investment fraud in the bio-fuel industry. The defendants were sentenced to between six and 13 years each, although the UK Bribery Act convictions only accounted for part of the significant sentences received by these individuals on multiple fraud counts.

Meanwhile, SFO is investigating, and has yet to resolve, several significant, high-profile corruption matters. In particular, SFO has formally announced ongoing investigations of UK-headquartered companies Rolls-Royce (in December 2013) and GlaxoSmithKlein (in May 2014). How SFO handles these and other high-profile instances of international corruption in the coming months and years will be an important indicator of the progress of anti-corruption enforcement in the UK Bribery Act era.

The UK prosecutors have continued to investigate and charge individuals and companies with corruption-related offenses pre-dating the UK Bribery Act. In December 2014, the company Smith and Ouzman Ltd, a UK printing firm that specializes in security documents such as ballot papers and certificates, was convicted of three counts of corruptly agreeing to make payments, contrary to section 1(1) of the Prevention of Corruption Act 1906. Two of the company's employees were convicted at the same time. These convictions arose from corrupt payments of around £400,000 made to public officials in Kenya and Mauritania, to obtain contracts for the company between 2006 and 2010. This case is a milestone for anti-corruption enforcement in the UK, as it marks the first conviction, after trial, of a company for offenses involving bribery of foreign public officials to have been successfully brought by SFO.

In July 2014, a UK subsidiary of Alstom (whose U.S. parent was more recently subject, in December 2014, to a record-breaking FCPA settlement) was charged with three counts of corruption. The alleged offenses are said to have taken place between June 2000 and November 2006, and concern large transport projects in India, Poland and Tunisia. In July 2014, Bruce Hall was sentenced to 16 months prison term in the UK, for receipt of payments and conspiracy to bribe in relation to Bahraini aluminum contracts. His conviction arose from facts emerging from the Alcoa U.S. FCPA settlement of January 2014. These two cases demonstrate a growing trend of international cooperation between the UK and U.S. authorities in prosecuting corruption cases.

3. Italy

a. Legislative Developments

In November 2012, the Italian legislature adopted a new law providing heavier sanctions for bribery-related crimes. Among other things, the new Law No. 190, "Measures for the prevention and repression of corruption and illegality in the Public Administration," introduced the offense of commercial bribery, which prohibits bribery of directors, officers and certain other persons with fiduciary responsibilities of private companies.

Notably, the Italian government is currently discussing a new law that will increase the minimum sanctions for bribery, and that will provide that penalty suspensions and leniency provisions normally available for first-time offenders will not apply to bribery convictions.

b. Enforcement Trends

Italy has not seen any enforcement actions involving the luxury and fashion industry. This is likely due to the fact that the luxury and fashion industry (unlike construction, energy, defense and infrastructure industries) does not generate significant income from business with the government. However, recent developments related to compliance programs are noteworthy for all companies, including those in the luxury and fashion industry.

Under Legislative Decree No. 231, dated 8 June 2001, companies may be held directly liable for bribery-related crimes committed by their representatives. The same law provides that a company may avoid liability if it adopts and implements an effective compliance program that is able to prevent and detect the commission of crimes. Therefore, compliance programs, if implemented and regularly updated, would have the effect of exempting a company from liability arising from crimes committed by its representatives.

An Italian Supreme Court judgment of March 2014 provides important guidance on the compliance program requirements that would allow companies to avoid criminal liability for bribery. The case indicates that a program must be adapted to the specific business operations of a particular company, address the risks faced by the company, and reflect the current and actual structure of the company itself. The case makes it clear that a “paper program” would not allow companies to avoid liability.

Companies in the luxury and fashion industry usually apply the compliance program guidelines adopted by Confindustria, the main Italian association representing manufacturing and service companies. These guidelines were adopted on 14 March 2014 and were subsequently approved by the Italian Ministry of Justice.

4. France

a. Legislative Developments

Prompted by several corruption-related scandals involving high-profile politicians in recent years, a number of new provisions have been added to France’s anti-bribery legislation within the last 12 months.

The most recent changes include an increase in the range of available sanctions, the introduction of leniency provisions and greater protection of whistleblowers to boost detection of bribery, and the establishment of dedicated enforcement authorities with extended investigative powers to focus on bribery and related offenses. Many of these changes were introduced by Law No. 2013-1117 of 6 December 2013, relating to the fight against tax fraud and large economic and financial crime (the 2013 Anti-Fraud Law), Law No. 2013-907 of 11 October 2013, relating to public sector transparency (the 2013 Transparency Law), and Law No. 2013-1115 of 6 December 2013. Given that these laws are recent, it is premature to draw conclusions as to their effect on enforcement activity in practice. However, they illustrate an increased interest on the part of the French legislature in ensuring the efficient enforcement of French anti-bribery laws.

b. Enforcement trends

France has been criticized by the OECD for its lack of prosecution of bribery in international business transactions. In its 2012 report, the OECD raised concerns relating to the (i) lack of prosecution of international bribery offenses; (ii) low number of convictions for bribery of foreign public officials; and (iii) ineffective and disproportionate application of sanctions.

The new laws described above were adopted in part to address such criticism from the OECD. The recent reforms, although welcomed by the OECD, do not address all of the previous recommendations, as outlined by the OECD Working Group in a recent statement issued in October 2014. While acknowledging that 24 new corruption cases had been initiated since October 2012, the OECD Working Group pointed out that French companies were not prosecuted or sanctioned in France for bribery of foreign public officials, even when they have already been prosecuted in other countries for the same offense.

The low enforcement numbers may be about to change. As mentioned, several corruption scandals relating to high-profile politicians have made the headlines during recent years, illustrating a greater willingness by French authorities to scrutinize the behavior of public officials. Further, although it is premature to assess the impact that the recent reforms will have on enforcement activities, the French authorities have lately emphasized their intention to increase prosecution of bribery.

B. Americas

1. Brazil

a. Legislative Developments

The new Brazilian Anti-Bribery Law was adopted on 29 January 2014. The Anti-Bribery Law imposes civil and administrative liability on legal entities for acts committed against domestic or foreign public entities.[33] The Brazilian Anti-Bribery Law not only prohibits acts of corruption, but also other acts against public administration, mainly related to fraud in public tenders.

The law imposes a strict liability standard on legal entities, which means that authorities only need to demonstrate that acts prohibited by the law were committed in the company's interest or on its behalf, and it is not necessary to demonstrate intent or fault. Legal entities can also be held liable for acts committed on their behalf by third parties.

Companies need not receive any benefit as a result of the improper conduct. The act of giving or offering an undue advantage to a government official, or someone related to such an official, is sufficient to violate the law.

Unlike the FCPA, Brazil's Anti-Bribery Law does not provide an exception for facilitation payments of small value given to government officials to perform or expedite non-discretionary activities. Such payments are prohibited in Brazil. Indeed, the Brazilian Anti-Bribery Law does

[33] In Brazil, only individuals can be subject to criminal liability.

not provide any defenses or exceptions for acts of corruption. However, it sets forth factors to be taken into consideration when determining sanctions. Among those factors are a legal entity's cooperation with an investigation of wrongdoing and the existence of an effective compliance program.

The law also provides an option for companies to enter into leniency agreements with the government if they effectively cooperate with the investigation. Such cooperation must result in the identification of the participants and collection of evidence involved in illegal conduct. Furthermore, companies can only enter into leniency agreements if all of the following requirements are present: (i) the company is the first one to come forward; (ii) the company completely ceases its involvement in the illegal conduct; and (iii) the company admits its participation in the offense and fully cooperates. Leniency agreements do not exempt companies from the restitution of damages but they exclude all other sanctions. Additionally, leniency agreements can reduce fines by up to two thirds.

b. Enforcement Trends

Brazil is a country with high risks of corruption, which makes interactions with government officials and dealings with governmental entities a significant concern for Brazilian companies and for foreign companies with operations in Brazil. Nonetheless, the fight against corruption has increased in recent years. In 2013, the Brazilian Federal Police conducted 296 special operations, which resulted in 1,785 individual arrests. In 2014, there were 229 special operations, which resulted in 1,748 arrests.[34]

Additionally, in recent years, Brazil has increased its cooperation with foreign authorities, pursuant to mutual legal assistance treaties (MLATs) and letters rogatory. Such cooperation has resulted in the exchange of information and evidence being obtained by regulatory agencies in various jurisdictions.

Because the Anti-Bribery Law was only recently adopted and the federal regulations implementing it have not been issued, the law's impact on anti-corruption enforcement in Brazil is yet to be seen.

2. Mexico

a. Legislative Developments

The most notable anti-corruption development in Mexico over the past year has been the debate over a number of reforms aimed at strengthening the fight against corruption. The anti-corruption reforms were among a number of promises – collectively referred to as the Pact for Mexico – made by a coalition of Mexico's main political parties. Currently, the anti-corruption reforms are pending. Nevertheless, the legislative proposals are sufficiently advanced to get a sense of the shape of the final reform.

The anti-corruption reforms proposed thus far envision the creation of several new entities responsible for anti-corruption enforcement. The first is an independent anti-corruption agency tasked with investigating instances of corruption. The current proposals have alternatively

[34] http://www.dpf.gov.br/agencia/estatisticas

suggested the creation of a new independent anti-corruption commission, or reforming the Ministry of Public Administration (SFP) to make it stronger and more independent. The second new entity envisioned under the reform is a special prosecutor for anti-corruption crimes, organized under the office of the prosecutor general. The legislation creating the special prosecutor was passed in 2014. Nevertheless, as of the time of writing, the Mexican Congress still has not nominated an individual to fill this post.

Companies in the luxury and fashion industry should be aware of Mexican anti-money laundering laws. Mexico recently adopted a new anti-money laundering law that specifically applies to non-financial entities meeting certain criteria. Included in this list of criteria are companies that sell watches and jewelry valued above a certain threshold. Mexico adopted this law to combat the use of luxury goods purchases as a way to launder the proceeds of the drug trade and other organized crime. Companies covered by the law are required to adopt compliance programs and file regular reports with the Mexican authorities.

b. Enforcement Trends

Anti-corruption enforcement in Mexico has not been robust, and is often inconsistent and arguably politically motivated. Responsibility for anti-corruption enforcement is shared across multiple agencies; most importantly, SFP and the office of the prosecutor general. Although SFP has the ability to levy and collect fines for corruption-related offenses, only the prosecutor general can impose criminal sanctions. In recent years, SFP has demonstrated a notable increase in activity. Indeed, from 2012 to the present, SFP has collected fines amounting to US$470 million; in contrast, over the preceding 20 years, SFP collected only US$6 million in fines. Nevertheless, it is not uncommon for cases investigated by SFP not to be pursued by prosecutors, or, when they are pursued, for those cases to be held up in the courts for years. Thus, the criminal side of anti-corruption enforcement has not kept pace with SFP's increased activity.

C. Asia Pacific

1. India

Over the last decade, the Indian retail industry has experienced remarkable growth. A subset of that industry, India's luxury and fashion market (including both foreign and domestic luxury products), is similarly growing at a rapid pace. In 2013, the luxury market grew at a rate of 30 percent to reach US$8.5 billion, and was estimated to reach US$14 billion by 2016.[35] The customer base for luxury products is widening, leading to international brands increasingly localizing their offerings to the Indian market.

In this unprecedented time of growth, corruption continues to be both a perceived and an actual risk for companies in the market. Like other emerging markets, India has quickly developed its economy but not disassociated itself from the high corruption risks of the developing world. Surveys find respondents articulating views that bribery in India is a way of "getting things done – otherwise, processes are slow." Like officials in many other countries, Indian officials at times succumb to the temptation of creating obstacles to decrease efficiency and enrich themselves.

[35] ASSOCHAM and KPMG, "India Luxury Summit 2014" at p 3.

Indian officials do not simply take and ask for cash; they will also take and ask for products and, given their high value, luxury products are particularly attractive.

Despite this negative perception, little remains static in India. A rapidly changing political environment and new political leadership present opportunities to enhance the upward transparency trajectory. The election of the Indian Prime Minister, Narendra Modi, and his taking office in May 2014, has elicited many optimistic appraisals of the future of the Indian economy. What commentators have widely referred to as the "Modi Revolution," or "Modi Effect," portends that the Modi era in India will be marked by a streamlining of bureaucratic hurdles, increased transparency, and greater integrity among Indian officials. Although it is impossible to make any broad assessment of Modi's effectiveness at this early stage, anecdotal evidence suggests that positive changes have begun to occur, such as:

- the government has prohibited the Diwali gifts directive in state-run finance companies;[36]
- industrial licenses now have to be renewed every seven years, where previously they had to be renewed every three years;
- environmental clearances can be obtained online and through self-declaration, rather than through a complicated inspection, often requiring personal attendance at government offices;
- companies that need clarification about regulations can now get answers online within 72 hours; and
- the revenue department has adopted new guidelines to avoid "frivolous" appeals in court.[37]

Among the key indicators of reform, any changes in government enforcement will be closely scrutinized. Whether the changes in India go beyond mere rhetoric will be measured by the new government's commitment to enforcing the existing anti-bribery regime.

a. Industry Risks in India

In this context, where both broad corruption risks and the potential for enhanced local government enforcement exist, the key risks for the luxury and fashion industry operating in India are those that arise from (i) partnering with local companies or retaining third parties to enter into the Indian retail market; and (ii) procuring regulatory approvals, including for the high-level real estate required in this industry.

b. Partners and Consultants to Facilitate Entry to the Indian Market

International luxury and fashion brands are now permitted to enter the Indian retail market via single brand retail stores by partnering with domestic Indian companies: new Indian laws permit these licensing, franchising or sub-licensing arrangements to involve foreign direct investment of up to 100 percent in the local company.[38] However, if a foreign company makes an investment of more than 51 percent in the local company's capital, the government requires that its Indian entity

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[36] http://timesofindia.indiatimes.com/india/Say-no-to-Diwali-gifts-Govt-diktat/articleshow/44892325.cms
[37] http://www.incometaxindia.gov.in/Lists/Press%20Releases/Attachments/335/PRESS-RELEASE-7-11-2014.pdf
[38] Government of India, Ministry of Commerce and Industry, Department of Industrial Policy & Promotion (FC Section), 'Consolidated FDI Policy Circular of 2014' (effective 17 April 2014), at paragraphs 6.2.16.3 (pp 63-64) (available at <http://dipp.nic.in/English/Policies/FDI Circular_2014.pdf>).

procures at least 30 percent of the value of the Indian entity's purchases from within India.[39] This gateway for international brands to enter the Indian retail market comes with its own corruption risks. In particular, partnering with an Indian company or retaining local consultants can be a risky proposition where such parties often lack appreciation for anti-corruption compliance. Furthermore, purchasing goods from within India adds corruption risk to a company's supply chain.

If the company retains any consultants to assist its entry into the Indian market, expansion of its Indian business, or any government-facing interactions, these consultants should be closely vetted prior to any engagement. This is especially the case for consultants retained for "liaising" with government agencies. In India, the term "liaising" is often used to describe interactions with government to procure regulatory outcomes, such as obtaining permits or licenses, and companies commonly retain agents to perform these "liaising" services. The activities performed by these agents are not prima facie improper; however, in many cases, the services are ill-defined and the fees charged vague or opaque, leaving open the opportunity for bribes to be paid to public officials in exchange for regulatory outcomes.

While, to date, there have been no reported FCPA cases against companies for corrupt actions of foreign franchisees, the wording of the FCPA and U.S. government actions suggest that SEC or DOJ may be inclined to charge a franchisor for actions of a franchisee. Most franchisors exercise a high level of control and oversight over their franchisees; it is unlikely to be a difficult threshold for a U.S. regulator to meet in the luxury and fashion industry, where franchisors need to vigilantly monitor franchisees to ensure consistent adherence to high standards of quality. Accordingly, if a foreign luxury brand enters the Indian market by the franchising route, it should require Indian franchisees to adhere to the same anti-corruption policies and procedures, and closely monitor their adherence to them.

c. Importation of Luxury Goods

Although not a risk associated with India alone, India is a jurisdiction with high risks of bribery during the importation and transportation of luxury products. Import duties on luxury products are particularly high in India, and this situation may offer incentives for improper activity, as organizations attempt to find avenues to bring in goods in a timely manner and with minimal costs. In our experience, the bonding system is particularly susceptible to abuse. Third parties may purport to offer consultancy services for obtaining de-bonding from customs, but offer only vague descriptions of services for activities that an organization may be legitimately entitled to but that are subject to bureaucratic delay.

d. Real Estate Transactions

The corruption risks inherent in real estate transactions are amplified in India, given the lack of quality luxury space and environments. Two of the common pitfalls faced by the luxury and fashion industry in India are in the valuation process and in obtaining permits for particular types of buildings. These challenges are heightened for the luxury and fashion industry, where brands

[39] Government of India, Ministry of Commerce and Industry, Department of Industrial Policy & Promotion (FC Section), 'Consolidated FDI Policy Circular of 2014' (effective 17 April 2014), at paragraphs 6.2.16.3 (pp 63-64) (available at <http://dipp.nic.in/English/Policies/FDI Circular_2014.pdf>).

need to have consistent branding across countries but local officials exploit the permitting process to obtain improper benefits.

e. Managing Corruption Risks When Doing Business in India

Companies should take proportionate protective steps – some of which are described below (and others of which are described elsewhere in this chapter) to enhance their compliance program in order to confront these challenges. None of the risks described above is insurmountable: setting an appropriate tone within the organization and for partners, understanding and assessing the market risks to allow advance planning, adhering to good policies and procedures, providing training, and then exercising oversight, will permit efficient operation in this challenging environment.

A foreign luxury brand contemplating entry into the Indian market should, at the very least, conduct due diligence into its potential business partners, regardless of whether those partners will be merely intermediaries or franchisees, or more involved joint venture partners. If the company retains any consultants to assist its entry into the Indian market or expansion of its Indian business, these consultants should be closely vetted prior to any engagement, and agreements with consultants should include anti-bribery provisions and warranties, as well as audit and monitoring rights (all of which should be exercised and/or enforced in a proportionate manner). Descriptions of services should be sufficiently detailed and companies should frequently ask, “Why can’t we provide these services ourselves and what is the value added by this third party?” Naturally, any potential joint venture partners must also be subject to extensive due diligence, and the terms of any joint venture agreement carefully structured to ensure that the company has sufficient compliance oversight and control.

It is vital that any consultants retained for liaising with government agencies – regardless of whether this is during the initial stages of entering the Indian market, when securing appropriate real estate, managing the supply chain process, or at any other point in time – are closely vetted and scrutinized, and agreements with them suitably documented. Agreements with these agents (and any other government-facing intermediaries retained by the company after due diligence) should include anti-bribery provisions and warranties, as well as audit and monitoring rights. Once retained, these consultants should be monitored closely. This will include requiring detailed descriptions of work performed on the company’s behalf, to ensure corrupt payments are not being made to accelerate the company’s progress, and closely scrutinizing invoices and supporting receipts submitted by these consultants (especially those for cash payments and poorly described activities with round figures or monies paid in advance of services being rendered).

Luxury and fashion industry companies should also provide anti-bribery training to their Indian franchisees, joint venture partners and government-facing intermediaries, or, at the very least, provide those parties with guidelines on acceptable travel, entertainment and gifting expenses (particularly with respect to public officials). While not always permissible under Indian law, culturally and socially, it is a common practice in India to present gifts during religious and other festivals, as well as for weddings and family celebrations. As such, gifts – including companies’ products – are sometimes used to mask bribes, and, given the high value of luxury and fashion companies’ products, companies operating in India are advised to assess whether their policies and procedures adequately control the risk. Ensuring policies dictate when gift giving is allowed, appropriate amounts adjusted for the market conditions, and when items can be loaned or given as promotional items, are essential components of the necessary compliance controls. The luxury and fashion industry faces a particular dilemma when giving promotional items in the Indian market that could be seen as *per se* extravagant.

2. China

For most players in the luxury and fashion industry, China is an important market with great potential that, at the same time, poses significant compliance risks. On the one hand, Chinese consumers continue to represent the largest and fastest-growing market for luxury products. On the other hand, China has always been viewed as one of the high-risk jurisdictions for corruption issues.

Starting in November 2012, when President Xi Jinping took office, Chinese government authorities launched an unprecedented anti-corruption campaign. For the first time, such an anti-corruption campaign has been touted as a “life or death” priority for the China Communist Party. As part of their anti-corruption efforts, Chinese prosecutors have investigated top-ranking Chinese officials, as well as Chinese subsidiaries of multinational companies, both of which had not been a focus of prior enforcement efforts.

So far, the luxury and fashion industry as a whole has not been a top priority for the Chinese government’s anti-corruption campaign, although high-end wine and spirits remain one of the targets for commercial bribery investigations. Nonetheless, given the increasingly stringent regulatory and compliance environment and the fast-changing enforcement landscape in China, it would be prudent for companies in the luxury and fashion industry to conduct regular risk assessments based on local realities, to tailor their compliance policies and internal control measures to address local customs and business practices. Companies must also ensure the availability of sufficient compliance resources at the local level, and maintain the independence of the compliance function within the organization.

a. Relevant Legislative Developments

In recent years, the Chinese legislature has made various efforts to shift the focus of anti-corruption enforcement from bribe recipients to bribe payers, and introduce a stricter anti-graft regime and tougher sanctions for those involved in corruption. Government authorities have also issued special rules targeting corruption in particular industries. There are no special anti-corruption rules applicable to the luxury and fashion sector. However, the market for luxury goods has been negatively affected by the anti-corruption campaign, which, to some extent, has made luxury goods less popular as gifts to government officials and business partners. That impact became obvious after government authorities, on 4 December 2012, adopted the “eight-point” anti-bureaucracy and formalism rules, which aim to eliminate bureaucratic waste, extravagant spending by officials for unnecessary purposes, and other abuses of public money. Various implementation rules for these “eight-point” guidelines have been issued in different provinces and by different government authorities. On 29 October 2013, the State Council and the Central Committee of the China Communist Party issued the Party and Government Authority Austerity and Anti-Waste Regulations. These regulations ban extravagant spending by government officials and Communist Party members. According to a report by Bain & Company, issued in October 2014, luxury spending in China appears, for the first time, to be on the decline, showing minus 1 percent growth for 2014 (at constant exchange rates, minus 2 percent at current ones), due to greater controls on luxury spending and changing consumption patterns.[40]

b. Enforcement Trends

The current anti-corruption campaign has been viewed as the most sustained effort against high-level corruption since the economic reforms in China in the early 1980s.[41] According to the statistics released by the Central Commission for Discipline Inspection of the China Communist Party, in 2013, more than 182,000 officials were subject to disciplinary or administrative punishment, an increase of 13.3 percent over 2012.[42] In December 2013, the Central Committee of China Communist Party published a five-year plan (2013-2017) for building a system to punish and prevent corruption. The plan calls for particular efforts to deal with cases involving power-for-money deals, judicial corruption, and major incidents involving both official and commercial bribery. In 2014, Chinese government authorities continued their anti-corruption investigations across different industries, including oil and gas, pharmaceutical, automobile, media and universities. Although most of these anti-corruption efforts were targeted at state-owned or state-controlled entities, private entities have also been involved at different levels. Indeed, for the first time since China adopted its open-door policy to attract foreign investment in 1980s, Chinese subsidiaries of multinationals became the targets for Chinese authorities' high-profile anti-corruption enforcement action for bribery crime. In a recent case involving the Chinese subsidiary of a UK-based multinational pharmaceutical company, four senior executives of the company were detained, all of whom allegedly offered bribes by funneling up to RMB3 billion (approximately US$486 million) to Chinese healthcare professionals through travel agencies, using false and fraudulent invoices, with the purpose of promoting sales of the company's products. In September 2014, a Chinese court issued the ruling and imposed a recorded fine of RMB3 billion on the company for commercial bribery, and five members of the company's senior management received prison sentences ranging from two to four years for bribery and other crimes. This case is one of many similar efforts against corruption involving Chinese subsidiaries of multinational companies or their executives. In fact, according to public news reports, starting from the latter part of 2013, Chinese government authorities launched industry sweep investigations on alleged commercial bribery activities committed by Chinese subsidiaries of multinational companies across the country, and "dawn raids" have been used frequently as a tool to collect documentary evidence, such as email communications and other electronic records, from those companies.

Chinese government authorities have made clear their intention that anti-corruption enforcement action will continue and strengthen in the future. In October 2014, the fourth plenary session of the 18th China Communist Party Central Committee laid down major tasks for

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[40] See more details at http://www.bain.com/about/press/press-releases/bain-and-companys-2014-annual-global-luxury-study.aspx

[41] Quotes from Andrew Wedeman, a political science professor at Georgia State University and author of "Double Paradox: Rapid Growth and Rising Corruption in China." See the source at http://www.bloomberg.com/news/2014-03-03/china-s-xi-broadens-graft-crackdown-to-boost-influence.html.

[42] See more details at http://www.gov.cn/gzdt/2014-01/11/content_2564326.htm (in Chinese)

comprehensively advancing the rule of law in China. It highlighted the need to accelerate the building of a law-abiding government, to ensure the fair administration of justice, to improve the credibility of the judicial system, to promote public awareness of law, and to enhance the building of a law-based society. It is expected that the rule of law will give more impetus to the current government's drive to eliminate corruption at all levels of the government. Making anti-corruption efforts regularly and systematically has been heatedly discussed among the Chinese government authorities and China Communist Party members.

Undoubtedly, the rapid development in China's anti-corruption landscape, as well as its increased enforcement action, pose a great challenge for multinational companies doing business in China. The luxury and fashion industry is not immune to this challenge. It would be advisable for players in this industry to establish the right tone at the local leadership level; conduct regular compliance risk assessments; improve compliance policies and internal controls by addressing identified risks; conduct effective compliance training; and impose rigorous monitoring, auditing and testing measures.

Chapter 9: Negotiating and Securing Retail Lease Space[1]

I. Global Insights and Observations

Successfully negotiating and securing retail space plays a vital role in the luxury and fashion business.

The physical presence of a luxury or fashion brand defines and underpins its personality and image. It is fundamental to shaping a brand's profile and experience, as well as to driving its success. Therefore, getting the dynamics of a brand's bricks-and-mortar offering right is critical.

For the most part, retail brands secure their premises through leasing retail outlets and stores. These lease agreements, by their nature, involve premises in sought-after key retail locations and require committing to long-term contracts of up to 20 years or more to secure. Accordingly, the arrangements and the liabilities under these lease commitments need to last the test of time through market cycles and brand changes.

Thereafter, occupation costs over the duration of these long commitments directly and immediately impact store profitability. Real estate decisions are strategic in nature, and require careful planning and a deep understanding of the allocation of cost, risk and local market conditions, as well as providing for flexibility for change over time to build, preserve and manage store and brand profitability.

In this chapter, we look at the elements and issues that are key to successful real estate negotiation.

Many leading brands have taken advantage of the rise in affluence in the Asia Pacific, where retail store expansion has been aggressively and rapidly pursued in the key markets, such as China, Hong Kong and Singapore, as well as in newer markets, such as Vietnam. More recently, emerging markets, such as South America and Africa, are also being targeted. In more established markets, we have seen a trend of the major brands focusing their retail presence around the development of iconic flagship and concept stores.

We have also seen the spread of real estate investment trust (REIT)-type structures into new jurisdictions, building sophistication into shopping-center developments with luxury precinct offerings, and, at the same time, bringing increased sophistication to the lease negotiation process and final documentation.

In contrast, we are also observing a proliferation of brands, and the impact of market overcrowding and an excess of store expansion by some brands. Coupled with the rise of e-commerce offerings, this has led to brand saturation and the slowing of demand in some markets. This, in turn, has hurt the luxury and fashion business and caused reduced store traffic and store profitability, causing caution. Many heritage brands are moving to reassert their brand image and management by canceling concessions and licensing arrangements to take back direct

[1] Principal authors are John Fabbro, Australia; Dominique Lechien, Belgium; Herve Jegou, France and Florian Thamm, Germany. Country-specific issues were prepared by John Fabbro, Australia; Dominique Lechien, Belgium; Joao Francisco Regos, Brazil; Stephen Turner, England and Wales; Hervé Jégou, France; Florian Thamm, Germany; Priscilla Yu, Hong Kong and China; Pierfrancesco Federici, Italy; Alexander Jampel, Japan; Jose Larroque, Mexico; Konstantine Kouzine, Russia; Bilal Ambikapathy, Bahrain; Steven Henderson, United Arab Emirates; Michael Smith, United States.

control. Once control has been regained, these brands often seek to redefine their image, typically leading to a rationalization or consolidation of their existing retail presences.

More recently, retail presences have also been changing, with the emergence of pop-up stores for some fashion and high-end consumer brands, and other brands seeking to carefully redefine their store presence with more elaborate and exacting fit-out standards. Against this is the advent of increased prominent outdoor advertising commitments by many leading brands.

The need to continue engaging customers by refining their brand experience, and for brands to differentiate themselves, makes strategy and flexibility around a brand's retail presence an essential part of negotiating and securing retail space.

II. Use of Letters of Intent

While letters of intent or heads of terms are not used in all retail lease negotiations in all countries, the preparation and negotiation of a letter of intent that will serve as a guide for the negotiation of the definitive terms and conditions of the lease is highly recommended. Going directly into a lease negotiation poses a danger that the bargaining power of the respective parties will be altered without a sufficient level of agreement or understanding as to the main terms of the transaction.

Letters of intent often vary in the level of detail included. The more details are included, the better the letter will be, as this will reduce the length of discussion during the lease negotiations and the risk of having to trade off key issues that are not covered in the letter of intent. A letter of intent has the benefit of addressing comprehensive terms at the outset.

Key issues that may be covered in a letter of intent are as follows:

- term and early termination provisions;
- cap on rent and service charges;
- lease assignment and subletting;
- escape clause, in case of destruction or significant damages to the store or the shopping mall;
- exclusivity and restriction on competitor tenants;
- scope of permitted activities;
- conditions precedent;
- signage and trading name use; and
- tenant allocations and improvements allowance.

Furthermore, it is recommended that the letter of intent include the following provisions:

- Each party may terminate the negotiation and not enter into any binding agreement at any time without any indemnity being due to the other party.
- No binding lease agreement will be entered into as long as it is not approved and signed off by the board of directors of the tenant or its parent company.

The letter of intent should also specify which of its provisions are:

- non-binding but express the intent of the parties;
- binding (such as exclusivity and confidentiality provisions); and
- are no longer subject to negotiations if a lease agreement is negotiated between the parties.

A letter of intent:

- serves as a basis for senior management review before board approval;
- identifies any significant precondition to a lease, such as premises availability, local licensing, town planning consents and final board approval before entering into the lease negotiations or their finalization; and
- protects the confidentiality of the negotiations and gives exclusivity to the prospective tenant during the lease negotiation process.

It is highly recommended that local counsel be involved in the review and negotiations of the letter of intent, although this is not a very common practice.

In some countries, a letter of intent is actually a required step, such as where head of terms or the lease agreement itself is needed to establish the local entity.

III. When is a Lease Transaction Binding?

In most legal systems, a binding agreement comes into force once the parties have agreed on the essential and substantial terms and conditions of the agreement without necessarily having actually signed the full, detailed and exhaustive contract. Lease agreements are generally considered to come into effect by the mere exchange of consent between the parties, without it being required that they enter into a formal deed or other instrument. Almost no country requires a written lease agreement signed between the parties for the lease to be binding.

This would not be the case, however, if the parties actually agree while entering into negotiations that they will enter into a binding agreement only upon the execution of the final and detailed agreement signed by authorized representatives of both parties (see "Use of Letters of Intent").

Some countries may require the registration or recording of the lease in a notarial deed or equivalent (see further discussion of this in "Process and Quality of Lease Documentation"); these requirements are generally for the purpose of evidencing certain terms of the lease or rendering the lease opposable to third parties. These requirements do not affect the binding nature of the agreement between landlord and tenant, which comes into place once they have agreed on the terms and conditions of the lease.

For the above reasons, and as further explained in "Use of Letters of Intent" and "Process and Quality of Lease Documentation", it is highly recommended that the parties sign a pre-contractual document, such as a letter of intent or head of terms. The pre-contractual agreement may specify under which condition the agreement would become binding between the landlord and the tenant, such as only when a final and detailed lease agreement satisfactory to both parties has been executed by authorized representatives following board approvals.

In the U.S., however, the applicable statute of frauds for the governing law state must be examined to determine if the lease must be in writing and executed before it is enforceable.

IV. Process and Quality of Lease Documentation

The process of negotiating and securing retail lease space is typically split into the following phases (some of which are may be skipped from time to time or are not applicable in certain jurisdictions):

- negotiation of the letter of intent/heads of terms (see "Use of letters of intent");
- negotiation of the retail lease documentation (see subsection A below);
- translation of the retail lease documentation, if required (see subsection B below);
- signing of the retail lease documentation (see "When is a lease transaction binding?");
- registration of lease, if required (see subsection C below); and
- payment of costs (see subsection D below).

A. Negotiation of the Retail Lease Documentation

The sophistication and the level of detail of retail lease documentation vary from jurisdiction to jurisdiction. A jurisdiction with a more mature retail market and legal system would most likely have more detailed lease documentation.

Nonetheless, there is a trend for retail lease documentation, especially shopping center leases, to be more and more detailed. This is true even in civil law countries, which tend to have less detailed contracts and rely on the applicable statutory law. This trend is largely driven by the fact that retail lease documentation often incorporates, and, to the extent legally possible, amends statutory lease law that would otherwise apply. For example, in Germany less than 10 years ago, it was hardly possible to find commercial lease agreements exceeding 25 pages. Today, the retail lease documentation of the operators of key shopping centers in Germany typically exceeds 60 pages.

It is, however, not just the level of detail that is increasing but also the quality of the agreement, as is the case in, e.g., Japan. Retail lease documentation is becoming more and more a standalone legal regime, governing the contractual relationship between the parties in one comprehensive legal document. This allows non-legally qualified staff to better understand the applicable legal regime.

In addition to the lease agreement, the lease documentation includes fairly extensive operational rules and regulations, particularly for retail stores in shopping centers. The number of annexes that must be attached to commercial lease agreements is also a demonstration of the increasing volume of retail lease documentation. In France, it is compulsory to attach different technical reports detailing, notably, the quantity of energy used in the building, the absence or presence of construction materials or products containing asbestos, and the natural risks of the zone in which the rented premises are located.

This trend also impacts the timing of the lease negotiations generally. The more detailed a retail lease documentation is, the longer it usually takes to bring the entire documentation to the agreed-on form, at least if the tenant has some leverage and bargaining power to negotiate the lease terms. In very hot markets, e.g., Hong Kong, it may only take a few days or weeks to get the transaction signed. However, if the commercial and legal terms of a lease are the subject of extensive negotiations, it can easily take a few months from the beginning of the negotiation until the signing.

B. Translation of Retail Lease Documentation

The length of the negotiations may also be affected by language barriers between the parties. If the retail lease documentation is drafted in a language the tenant is not fluent in, translations and/or lease summaries are often required. This may delay the process and needs to be factored in.

While most jurisdictions do not require the lease documentation to be in the relevant local language in order to be legally binding, certain jurisdictions have local language requirements. Lessors in some jurisdictions, such as Japan, customarily require the controlling lease documentation to be in the local language.

C. Registration of the Lease

Most jurisdictions do not require the registration of a lease. However, lease registration is required in certain jurisdictions, such as France (if the term of the commercial lease agreement is more than 12 years), Italy, Belgium (for paying the registration tax), England and Wales (if the lease exceeds seven years), Mexico (if the lease exceeds six years or there are three years of prepaid rent) and Russia. If the lease is not duly registered with the competent register and public authority, the lease does not become legally binding upon third parties but remains valid among the parties of the lease. In France, for instance, in the absence of registration at the Land Registry, the commercial lease agreement would only be enforceable for a period of 12 years.

Other jurisdictions require certification of the lease documentation, instead of registration.

Both registration and certification requirements trigger additional costs. In, e.g., France, when the term of a commercial lease agreement is more than 12 years, it must be drawn up by French notaries and registered with the Land Registry, thus triggering specific costs (see "Country-specific Issues"). Similarly, in Belgium, if a lease is entered for a period in excess of nine years, it must be recorded before a Belgian notary public. In Mexico, these costs can easily amount to several thousand dollars, as a notarial document and the payment of recording fees, which vary from state to state, are required.

D. Payment of Costs

The following costs may be incurred in the preparation and negotiation of retail lease documentation:

- broker/real estate agent commissions or fees;
- fees for legal advisors;
- translation costs;
- registration fees and certification costs; and
- key money.

Except for the registration fees, certification costs (see subsection C above) and key money, the costs are common in more or less all jurisdictions. Key money (the consideration paid by the tenant to either the landlord or the former tenant to acquire the ability to lease the retail space (see "Incentives and Key Money")) is very common in some but uncommon, or even prohibited, in other jurisdictions.

V. Key Licensing and Planning Controls

In many jurisdictions, retail stores may only operate after obtaining the necessary authorizations. Retailers will, therefore, have to find and secure the best possible locations through the negotiation and signing of commercial lease agreements and obtaining the necessary planning authorizations and/or operating licenses.

Different sets of rules will govern the planning authorizations, operating licenses and commercial lease agreements.

A. Dealing with Planning Issues

The first issue for retailers is to ensure that their products, goods and merchandise can be legally sold in the location of the lease premises. This will require the review of the applicable zoning regulations.

Please note that this review will have to be done for retail premises in streets or buildings where specific zoning regulations may apply, and where specific authorizations may have to be obtained from the public authorities and, as the case may be, from the co-owners.

Specific regulations, especially in historical city centers, may also limit the fixing of exterior signage and logos, thus requiring separate public authorizations.

Once the above review has been carried out and positive answers have been obtained, retailers will have to establish whether additional building authorizations have to be obtained for them to carry out their contemplated fit-out works. The delay in applying for and obtaining these authorizations from third parties will have to be taken into account when setting out a plan for the development of a chain of retail premises.

Obtaining these different authorizations free of recourse should be stipulated, as the case may be, as conditions precedent to commercial lease agreements.

B. Dealing with License Issues

In addition to obtaining the necessary planning and/or construction authorizations, retailers may have to comply with specific regulations, depending upon the merchandise, products and goods to be sold.

Thus, the second issue for retailers is to check if the business they want to carry out requires a specific operating license.

In most jurisdictions, specific regulations apply if alcohol or tobacco products are to be sold. In Russia, specific regulations apply for the sale of alcohol products, such as wines or spirits (see “Country-specific issues”).

Once again, obtaining these additional authorizations should be stipulated, as the case may be, as conditions precedent to commercial lease agreements.

Retailers will also have to pay specific attention to local regulations applicable to employment matters that may prohibit employees from working on Sundays and/or after specific hours in the evening. This issue may be regulated at the national and/or local levels. At the local level, differences may even exist between different districts within the same town.

C. Country-specific Issues

In addition to planning authorizations and operating licenses, specific authorizations may have to be obtained, depending upon the sales surface area.

This is notably the case in Italy, France and Belgium. In Italy, a distinction is made between sales areas with a surface area under or above 250 square meters. In France, a specific retail premises permit is required to open retail premises having a sales area in excess of 1,000 square meters. In Belgium, depending on the size of the retail area open to the public and the location of the shop, a permit would be required to operate the shop.

VI. Typical Rent Structures

Rent and occupancy costs are typically one of the highest expenditures in any retail operation.

The structuring of rents in retail leases across the key markets is typically characterized by a base rent component, which is referenced back to the area occupied by the retail premises on a per square meter or foot basis. In addition to base rent, it is usual that the retailer pays a component of the landlord's operating and building outgoings for the complex or shopping center where the premises are located (see "Outgoings and Pass-through Costs").

In more sophisticated retail markets with larger shopping center retail precincts, institutional-type landlords also seek to recover, as sales or turnover rent, a percentage of the retailer's revenue generated from the premises. Turnover rent typically kicks in at a prescribed threshold and may graduate in percentage terms as turnover increases. Needless to say, there are several administrative and accounting issues involved in effectively defining, capturing, calculating and auditing turnover rent.

Rent is paid at monthly intervals under most retail leases. Base rents are typically reviewed on an annual basis in many markets, benchmarked to an agreed percentage increase or to a cost-of-living index. Other markets use a review of the market at set intervals during the lease term, often on two-to-three-year cycles.

The assessment of fixed increases provides more certainty as to occupancy costs, while the assessment of market values can be a more involved process, as well as expensive and uncertain, particularly in markets where rent transparency can be an issue. This often requires that lease documents carefully specify the relevant criteria to be taken into account when undertaking a market-based rent review.

The right to dispute and challenge market review assessments of rent, and the scope and definition of what constitutes a comparable rent, often requires the assistance and service of experienced independent valuers.

With turnover rents, other issues arise, such as specifying with some precision in the lease a clear, unambiguous description of what constitutes turnover or gross sales. This has been particularly contentious with many leading retailers moving to e-commerce and online retailing, where product sales are seen as being generated from the retailer's brick and mortar premises.

Other issues relevant to turnover rent include the controlling of and maintaining confidentiality around the availability of turnover information that is commercially sensitive to the retailers. At the same time, landlords often seek the right for evidence to be provided and audits to be conducted to verify the reported turnover and revenue information.

Landlords sometimes seek to prevent base rents from falling due to reviews involving markets or cost-of-living-index-type rent reviews. This can result in a retail rent becoming out of line with prevailing market rates of rent, particularly where long-term leases are involved, or there is a change in the economic trading conditions, such as the global financial crisis or where the fortunes of certain markets or the retail precinct where the premises are located have fallen.

In some markets, there are rent controls and limitations on how rent can be calculated, reviewed and charged under retail tenancies, including restrictions on turnover rent in some cases. Sometimes, the benefits of these rent controls do not apply to large international retailers.

The assistance of experienced independent local advisors in negotiating and settling rent determinations and advising on rent provisions to be reflected in retail leases is fundamental, given the many prevailing differences across global retail markets.

VII. Outgoings and Pass-through Costs

A. Charges Payable by Tenant under Lease

In addition to rent, a tenant of a retail lease is usually required to pay: (a) charges in respect of the electricity, water, gas, telephone and other utilities consumed in or for the benefit of the premises; (b) service charges; (c) promotional levies; and (d) rates, levies, taxes, assessments, duties, charges, impositions and outgoings assessed that may be imposed by the government or other authorities upon the premises or upon the owner or occupier of the premises.

1. Utility Charges

The tenant will be required to pay for electricity, water, gas, telephone and other utility charges consumed in or for the benefit of the premises that are either shown by metered supplies or by accounts rendered to the tenant.

2. Service Charge

A service charge will be payable to reimburse the landlord for the cost of providing certain services to the premises. The services provided by landlords vary, but include the following:

- employing management agents;
- cleaning, maintaining, redecorating and repairing common areas (if any);
- maintaining and repairing structural elements of the building;
- maintaining landscaped areas;
- disposing of refuse;
- providing air-conditioning during normal business hours;
- operating restroom facilities in common areas;
- effecting insurance coverage; and
- employing help desk and security personnel.

The landlord always reserves the right to adjust the service charge from time to time during the lease term.

3. Promotion Levy

Some landlords charge a promotion levy for coordinating marketing and promotional activities for the shopping center. As with the service charge, the landlord always reserves the right to adjust the promotion levy from time to time during the lease term.

4. Other Outgoings

The tenant will usually be obligated to pay all rates, levies, taxes, assessments, duties, charges, impositions and outgoings assessed that may be imposed by the government or other authorities upon the premises or upon the owner and/or occupier of the premises, save for those payable by the landlord under the lease.

B. Cost and Control of Pass-through Costs

In negotiating a lease, the tenant will want the certainty of knowing in advance what the rent and other costs are going to be. Meanwhile, the landlord will want to ensure that it can pass on as many of its expenses as possible, particularly in respect of exceptional items of expenditure that are not budgeted for.

Among the charges payable by the tenant, the landlord cannot determine the utility charges and other outgoings payable by it, as such charges and outgoings are solely determined by the utility companies, the government or the authorities (as the case may be), and are based on either the actual consumption or the assessments by the government or the authorities. The landlord only has control over the service charge and the promotion levy.

The tenant has no right to demand information about the calculation or apportionment of the service charge and the promotion levy unless the lease contains express language to that effect. Hence, during the lease negotiation, the tenant may wish to include express provision(s) requiring the landlord to supply the relevant information.

The service charge and the promotion levy payable at the commencement of the lease term will be fixed, as the initial amounts payable at the lease commencement are usually specified in the lease. However, going forward, the landlord will reserve the right to adjust the service charge and the promotion levy, which creates uncertainty for the tenant. To ensure some predictability of costs, the tenant may request that any service charge or promotion levy adjustment be subject to a cap and the frequency of adjustment be limited to a fixed number of times during the term.

The fact that the landlord has the right to determine the service charge and the promotion levy at its discretion, coupled with the potential lack of information about the calculation or apportionment of the service charge and the promotion levy, can make it hard for the tenant to determine whether the service charge and/or the promotion levy consist(s) of capital costs and/or a sinking fund contribution. Unless there is express wording in the lease that the tenant does not need to contribute toward capital costs or a sinking fund, it is possible for the service charge and the promotion levy to contain elements of both or either of them.

VIII. Incentives and Key Money

Inducements and concessions are often offered by landlords to attract the best retail names to shopping precincts and centers. Often, these incentive arrangements are not transparent and are made subject to confidentiality arrangements. The impact of these incentive arrangements can distort the perception of prevailing market rent conditions. This can occur where the impact of the incentive is negotiated to push up the “face” rent value of the rent being paid and reflected in the terms of the lease to a much higher level than the “true” or “effective” rent being paid after taking into account the impact of the landlord-provided incentives.

The structure of these incentives varies. It may include cash payments or contributions to the retailer’s fit-out costs and the granting of rent reductions or concessions over a period of time during the lease term.

The enforcement of the incentive arrangements can become an issue when the building where the premises are situated is sold or the landlord is subject to enforcement and foreclosure from its financiers. Other issues arise from the nature of the payments being taxable in the hands of the tenant under local jurisdiction tax rulings.

The ability to transfer any incentive arrangements and entitlements can impact the commercial viability to transfer or assign the lease itself. There are often claw-back provisions for incentives to be repaid or ceased if there is a transfer of the lease or change of use under the lease.

Another feature in some markets is a payment being made to the landlord for the grant of a lease, in the form of “key money”. Key money is the consideration paid by the tenant to either the landlord or the former tenant to be able to lease the retail space. It is not common in many established markets, but it can be a feature of prevailing market conditions. Key money for the grant of a retail lease appears to be more common in developing or emerging retail markets. Interestingly, in some jurisdictions, the payment of key money for the grant of a retail lease has been prohibited by law. Where present, key money is often a critical feature in the negotiation of a lease.

In Belgium, France and Mexico, existing tenants very often negotiate and obtain a payment of a lump-sum amount of key money from the new tenant, which represents the value attributable to secure the location of the site. Landlords often require payment of key money on top of the security deposit, rent, fees and services charges.

In other jurisdictions, like Germany, key money payments are generally legally possible but very uncommon, unless paid as a consideration to an existing tenant to move its retail space (e.g., within the shopping center) or to vacate the leased space prior to the fixed lease term to allow the landlord to let the premises to a new tenant. In Japan, key money is less common, although some landlords still require the payment of it to help offset the real estate commission payable by the landlord to its real estate agent.

In Italy, the Supreme Court has excluded the legitimacy of any key money paid by the future tenant to the landlord. Nevertheless, it is not uncommon for a sort of “key money” to be paid in the form of an increased rent. Key money paid to the current tenant has been approved by the Italian Supreme Court, provided that the landlord is not involved and does not receive any economic advantage from it.

The documentation structure and timing of the payment of key money need to be understood thoroughly, as does the tax effect of any payment. Caution also needs to be exercised in some markets to ensure the nature of the payments is legal and the identity of the party receiving the payment is clear, to ensure that the payment does not fall foul of bribery and anti-corruption laws and regulations.

IX. Lease Term and Duration

Some countries (such as France, Belgium and Italy) have adopted specific statutory provisions for retail leases that are protective of the tenant and that define the lease term, the options to renew and their mechanics, as well as the early termination possibilities. These statutory provisions cannot be varied by the parties, or can be varied only to a certain extent, as defined by the applicable statute. Further details regarding these specific statutory provisions can be found in "Country-specific Issues".

In Germany, there are strict form requirements to be observed for the contractually agreed term to be binding. In countries where there is no such specific statutory provision, retail lease terms will usually range between three and 10 years (often five or six years), with international retailers usually taking the longer terms with a termination option. Brand exit and termination for convenience clauses are common for new market entrants, but these require an exit cost. In longer-term leases, the landlord may grant the tenant a right to terminate the lease, which usually comes out with an exit cost and may only be exercisable after a specified period of the lease term has passed.

The lease will typically contain provisions with respect to the condition in which the leased premises will have to be returned to the landlord, notably with respect to leasehold improvements and modifications made by the tenant at the beginning of or during the lease. Very often, the landlord will try to require that the leased premises be returned to their original condition, while the tenant will negotiate to be able to leave the premises as they are at the end of the lease, with the ability to remove from them the specific improvements and changes made for the tenant.

X. Assignment, Transfer and Subletting

In a perfect world, a tenant of retail space will enter into a lease agreement and operate its business successfully during the fixed term of the lease. The chosen location proves to be excellent, customers come in droves and turnover is good, so the retail tenant is happy to renew the lease after its expiry or to exercise any extension options granted. However, the reality is often different. Most leases, therefore, contain assignment, transfer and subletting provisions, providing the tenant with the necessary flexibility to act when a store is not performing well or the tenant wants to change its store concept or brand. A change to the leased space may not always be for an unpleasant reason: e.g., the tenant may be interested in enlarging its store but there is no expansion space available in the respective complex. In all these scenarios, a tenant may only assign, transfer and/or sublet the leased space to third parties if the lease allows it to do so.

Accordingly, retail tenants would usually negotiate provisions entitling them to assign, transfer and/or sublet the leased space in full or in part to third parties. However, landlords are usually averse to any changes by their tenants in which they have no influence, especially if they were happy with a certain tenant or the tenant was a perfect match for the tenant mix in the shopping center (e.g., a strong brand attracting many customers). Landlords are often even required to keep control over their tenant population in the event they have granted some of their other tenants protection from competition (non-compete clauses), which is often the case in shopping center leases. If their tenants could freely assign or sublet leased space to such competitors, the landlord would be in breach of its contractual obligations toward the tenants benefiting from such non-compete clauses, exposing the landlord to a risk of damage claims by this type of tenant or even an early termination of its lease.

For these reasons, any assignment, transfer or subletting usually requires the landlord's prior written consent. However, how the relevant provisions are drafted in retail leases (e.g., whether the landlord may only withhold, place conditions on or delay its consent for good cause or at its sole discretion) can still make a huge difference. In addition, the clarification that the tenant is entitled to assign the lease agreement or to sublet space to an affiliated company and/or subsidiaries can prove to be very helpful for retail tenants in the event that the leased space turns out to be a better location for an affiliated brand or the tenant decides to withdraw one of its brands from a certain jurisdiction.

The landlord's consent can be granted in the lease or granted afterward. If the consent is granted after the execution of the lease, it depends on the applicable local law whether the consent must be granted in a three-way addendum to the lease between the landlord, the tenant and the assignee/transferee/subtenant; or in a two-way addendum to the lease between the tenant and the assignee/transferee/subtenant, with the landlord's consent being granted in another form (e.g., in a side letter). In Germany, a sublease agreement will, in general, be concluded between the tenant and the subtenant with landlord's prior (written) consent being granted to the tenant. In contrast, an assignment of the entire lease agreement will usually be concluded in a three-way-addendum between all parties.

The exceptions to this rule, as well as the consequences of any break thereof may, however, differ from jurisdiction to jurisdiction. In Germany, a landlord may grant or withhold its consent to a subletting at its sole discretion, unless agreed otherwise. However, if the landlord withholds its consent other than for good cause, the tenant may then be entitled to terminate the lease for good cause. In commercial leases, such a termination right is often excluded. One possible way to balance the conflicting interests of both parties is to exclude the termination right but entitle only the landlord to withhold, place conditions on or delay its consent for good cause. In addition, subletting to affiliated companies or persons is very often permitted in German retail leases, in particular if there is a parent company guarantee in place protecting the landlord in the event of a default.

Unlike a subletting, in Germany the assignment or transfer of a lease always requires the landlord's consent. Although it is legally possible, German landlords are usually very reluctant to agree otherwise, unless the lease provides for very specific conditions to be met by the assignee for a permitted assignment or transfer (including, without limitation, its solvency, type of business, etc.).

This also applies in Mexico. In Japan, although it is legally possible, landlords are usually very reluctant to agree to permit without written prior approval any assignment, subletting or co-occupancy of the premises, or even to permit the address to be used for another entity, with an exception sometimes for the tenant's parent company or subsidiary. This is because landlords in Japan, like business owners in other industries, are concerned with the background and reputation of the counterparties with whom they are conducting business.

In France, the assignment and the transfer of a lease are usually subject to landlord's consent. Under French law, however, a tenant may assign its lease, together with the transfer of the business carried out in the leased premises, without the landlord's consent being required. This right in favor of the tenant is mandatory and will prevail over any deviating provisions in the lease.

In other jurisdictions, such as Belgium and Turkey, assignment and subletting are permitted by law. A tenant may freely assign the lease, for as long as the assignment or subletting does not have any adverse effects on the landlord. However, it is still possible that a stricter provision that is more favorable to the landlord will be included in the lease.

XI. Permitted Use Issues

Lease agreements typically contain provisions about the permitted use of the leased premises. Tenants usually cannot use the leased space at their free discretion, but only in compliance with the permitted use set out in the lease. The landlord of a retail premises would usually specify the permitted use as exactly as possible. Rather than just permitting retail purposes, the lease will typically describe the tenant's business and also reference the brand under which the store is operated, particularly in a shopping center or an outlet mall with a focus on a certain mix of merchandise.

A "narrow" permitted use clause restricts the tenant in running its business. In particular, if a tenant has more than one brand or operates different store concepts, it is not possible for it to sell its other brands without the landlord's consent. The same applies in the event that the tenant is only allowed to sell certain types of goods or operate a specific store concept.

Retail leases sometimes also refer to annexes in permitted use clauses, listing various categories of goods that may be sold within the store and the extent to which such goods may be offered and under which brand name(s) (e.g., that the tenant shall only be allowed to sell fragrances next to its men's and women's wear in a very limited percentage of the size of its entire store). While all of these restrictions may be acceptable to the tenant when signing the lease, it may change its view during the lease term. Hence, a broader permitted use clause is better for the tenant.

While major brands will probably be able to negotiate the right to use the leased space for any lawful retail purpose, smaller tenants or tenants in major shopping centers often have to accept specific permitted use clauses. In the latter case, the tenant should at least try to get the flexibility to sell additional goods or services that are typically sold or rendered in its other stores.

In general, the provisions about the scope of use and of the permitted business activities in the leased space are an essential part of any lease agreement for retail spaces, and typically lead to lengthy discussions between the parties, regardless of the respective jurisdiction. In many jurisdictions, such as Germany, France, Mexico and Japan, the parties usually agree on a certain permitted use of the leased space as well as of the goods that the tenant is allowed to sell there.

Any change thereof is then subject to the landlord's consent, which, from the tenant's perspective, the landlord should only be able to withhold, delay or place conditions on for good cause.

Finally, the permitted use clause in a retail lease should always be looked at in conjunction with the provisions on assignment, transfer and subletting. Even if assignment, transfer and/or subletting is permitted, the tenant is only free to assign, transfer and/or sublet the lease if and to the extent the future use of the leased space by the assignee, transferee and/or subtenant is still covered by the permitted use as set out in the (head) lease. In our experience, tenants often tend to forget the further restrictions following the permitted use clause when negotiating assignment, transfer and subletting clauses in retail leases. This is even more important, as landlords often try to define the permitted use as narrowly as possible (e.g., limiting the permitted use to selling a certain type of products under a certain brand name). In these cases, broad assignment, transfer and subletting clauses are pretty much worthless, as the assignee, transferee and/or subtenant will not be able to comply with the permitted use clause. Any amendment to the permitted use clause does, however, require the landlord's consent in an amendment to the lease. Accordingly, when negotiating the assignment, transfer and subletting clauses in retail leases, particular attention needs to be paid to the permitted use clause.

XII. Key Landlord Operating Requirements

A. Landlord's Repair and Maintenance Obligations

In general, the obligations imposed on a tenant under a retail lease are more extensive and burdensome than those placed on the landlord.

With regards to repair and maintenance, in the absence of an express provision, the landlord is generally under no liability to put the premises into repair at the lease commencement or to carry out repairs during the lease term. Some landlords who own the whole building may, however, be prepared to keep and maintain its common areas, to ensure that the building as a whole remains in a good and clean condition.

Notwithstanding this, in certain cases, a tenant will wish to insert wording into the lease specifying the landlord's repair and maintenance obligations. This will sometimes include a "self-help" remedy whereby, if the landlord fails to comply with its repairing obligations, the tenant can make the repairs itself and offset the rent to cover the cost of such repairs.

B. Refurbishment and Upgrading of Shopping Center

The landlord is under no obligation to refurbish or upgrade the shopping center unless the lease contains an express provision that imposes an obligation on it to do so.

Even if there is no obligation on the landlord to refurbish or upgrade the shopping center, the landlord may still reserve the right to carry out refurbishment or upgrading works at its discretion. The landlord also typically reserves the right to change or relocate the layout of the shopping center. The landlord is not obligated to exercise those rights, but if it does exercise any of them, the tenant cannot object to or claim any compensation whatsoever in connection with this.

C. Fitting Out of Retail Premises

Where, at the commencement of the lease, the tenant is to fit-out the premises, it is in the landlord's interest to ensure that the retail premises are fitted out in a good, proper and workmanlike fashion, using good-quality materials and, in all respects, in a style appropriate to a first-class shopping center. The landlord usually requests that the tenant submit fit-out plans and specifications for the landlord's approval before the fit-out work commences. Some landlords may also require a tenant, at the tenant's cost, to refurbish and upgrade the retail premises from time to time (usually at the time of the lease renewal).

International retailers may not welcome the idea of having their fit-out plans and specifications approved by a landlord, as they want to maintain a uniform global image. Due to the importance of their uniform global image, these international retailers usually submit their fit-out plans and specifications well ahead of time and include detailed information for the landlord's approval.

Sometimes, international retailers require the landlord to make modifications to a part of the shopping center (e.g., build a common area near the premises) or to the premises prior to the handover of the premises. The parties will need to discuss the details of the work involved (including its completion time) and include in the lease wording to that effect.

D. Operating and Maintenance Required from the Landlord

Under the lease, the landlord, or a managing agent on behalf of the landlord, will be required to provide certain services to the premises and the building's common areas. These may include: cleaning, lighting and furnishing common areas; providing waste management services; decorating the exterior of the building (i.e., landscaping and/or seasonal decorations); employing security and customer help desk personnel; procuring insurance cover; and advertising and promoting the shopping center.

Other operating conditions may require the landlord to keep the shopping center open during specified business hours and provide air-conditioning and other utilities during such hours. Where the premises form part of a shopping center, the landlord may also agree to reserve space on directory boards for the name of the tenant's shop or allocate a specified number of car parking spaces for the tenant's customers.

XIII. Security under Retail Leases

The landlord will typically require security under a lease agreement, in the form of a deposit or a bank guarantee for an amount equivalent to three-to-six months of rent. Usually, it is required that the bank guarantee can be called for payment upon a duly motivated request with evidence showing that the tenant has defaulted under the lease, but be subject to no other condition for payment.

As the landlord will require that the bank guarantee be maintained for the whole term of the lease, there can be an issue in obtaining one when the term of the lease is of a long duration. In such a situation, it is often required that the bank guarantee be issued for a shorter period, such as one to three years, and callable at the end of that period if it has not been renewed or extended at the request of the landlord.

In some cases, the tenant may negotiate that, in lieu of the deposit or bank guarantee, a parent guarantee be delivered in favor of the landlord. It is recommended that the parent guarantee be limited by a cap stating a maximum amount for which the parent could be held liable for the obligations of the tenant.

For any lease assignment, the assignee is usually required to deliver a new deposit or bank guarantee in lieu of the existing one issued on behalf of the assignor. The landlord, the assignor and the assignee usually make arrangements so that the assignor may recover the deposit or bank guarantee upon its remittance.

As the bank guarantee or deposit will often be provided for a duration continuing until three to six months after expiry of termination of the lease, the tenant will have to establish as soon as possible that all its obligations under the lease have been properly discharged to obtain the bank guarantee, or for the deposit be recovered or terminated, following such expiry or termination.

Some countries, e.g., Italy, impose a limit on the cash amount that can be requested by the landlord for the deposit.

XIV. Fit-out Contracting and Consultancy Engagement

A brand is not only defined by the quality of its product, marketing and clientele but, more particularly, by the “in-store” experience it provides to its discerning customers. Part of that experience is generated through the individuality, quality and ambience of the design and fit-out of a brand’s retail premises.

Part of successfully securing retail space for a leading brand is the ability to effectively undertake, within the constraints of time, cost and quality, what is typically a bespoke, unique and challenging fit-out.

This require early planning, and experience has shown that, all too often, getting a new store and brand presence launched is a race against time.

While this section is not intended to be a detailed look at the issues and contacting structures that are encountered in retail store fit-outs, it sets out some key factors relevant to fit-out contracting that arise at the lease negotiation phase.

One of the issues that is encountered at this early stage of the fit-out process is brands seeking to apply international fit-out and design standards to new jurisdictions and locations. Landlords, and, more often, the local planning authorities, and local experts are not always familiar with some of the unique design features, concepts and fit-out processes required by the relevant brand.

Brands need to be careful when working in new jurisdictions to ensure that effective and appropriate anti-corruption and good corporate governance measures are implemented for their fit-out process by their appointed personal consultants. This is particularly significant given that the construction industry and planning authorities are prone to this risk, often even more so in some emerging markets.

Fit-out issues and delays are often generated when the design process is being fully handled outside the jurisdiction and through a brand’s head office, which can be detached from the local on-ground conditions and requirements. This can lead to expectations being set that are locally impractical or unworkable, compounding delays and costing issues. The importance of the early involvement of an experienced, on-the-ground project manager cannot be overemphasized.

Problems are also often encountered when a brand's fit-out and consultant team are operating separately from the brand's store delivery and lease negotiation team. In an effort to minimize delays, the fit-out team may advance the commitment to the premises and approvals by direct dealing with the landlord while critical lease negotiations are still afoot; this can result in a tenant's negotiation position and leverage being significantly undermined. Brands need to ensure that this does not occur, through effective coordination and communication. Similarly, the fit-out team should ensure that commitments are not being made in the lease documentation that will adversely affect their ability to carry out and complete the required fit-out process on time.

Despite the above issue, tenants should also work to get their fit-out contract and consultancy engagement contracts in place early, to avoid delays. Experience has shown that contract delivery methods and consultancy engagements structures differ widely. While it may appeal to the head office, attempting to arbitrarily impose a particular contract structure can lead to non-customary contract provisions and project delivery methods that are unfamiliar to the local market. This may have the effect of increasing cost, excluding potential tenderers, extending contract negotiations and confusing the contract delivery process. There is some sense in using a local form of fit-out contract adjusted to include the tenant's critical "must-have" requirements, to smooth out the process, and avoid the increased cost and delays that result from seeking to impose non-customary terms.

Another issue to be aware of is that landlords may seek to have their nominated contractors and service consultants involved in any work carried out by the tenant within their building and shopping complexes. This issue should be identified and addressed early in the lease negotiations. At the very least, a tenant needs to assess the impact of often-exorbitant costing from nominated service providers, as well as having inappropriate consultants and contractors involved that may not be aligned with the tenant's longer-term interests.

More sophisticated landlords often use well-developed fit-out guides to control, manage and administer the fit-out process for premises they lease. These guides are often site specific and tailored to the particular complex. Ideally, the guides should also improve the structure of the fit-out process for tenants. It is important that the existence and review of any landlord-required fit-out guide is identified, understood and accepted before the lease is signed, particularly to ensure that the guide does not undermine the lessee's expectations and understanding of the fit-out process, and to ensure that the guide does not change the fit-out requirements, risk allocation and timing anticipated under the lease documentation.

Disputes commonly arise around construction and fit-out of retail premises. It is worthwhile seeking to agree with the landlord in advance in the lease documentation a suitable dispute resolution regime that allows for the prompt, efficient and cost-effective settlement of any such disputes. This, hopefully, will avoid recourse to more formal and lengthy dispute resolution through arbitration or court action.

Finally, the tenant should be very clear about the standard condition of and services that should be available in the premises at handover and ensure that this is clearly specified in the lease, to avoid confusion on a key practical point.

XV. Brand Protection in Retail Leases

Most retail leases are silent on brand protection. Accordingly, the applicable statutory law applies, which may differ from jurisdiction to jurisdiction.

As a general rule, landlords are entitled to use the trademarks and/or commercial designations of their tenants only if and to the extent: (i) the use does not qualify as the so-called "use as a trademark"; and (ii) the lease agreement does not explicitly exclude the use of the trademark by the landlord. The criteria for establishing a "use as a trademark" may vary from jurisdiction to jurisdiction, but generally require that the trademark is used for the purpose of distinguishing goods or services. If the tenants' brands are, e.g., merely listed on the orientation map of a shopping center, this will (at least under German law) not require the tenants' consent. This might be different if the information given implies a certain commercial relationship between the landlord and the tenants beyond the lease. If there is doubt, however, landlords should obtain the tenants' consents prior to using their brand. Although many brand owners may want their brands/logos displayed in the common areas and in promotional materials by the landlord, brand owners have a strong interest in a consistent and harmonized use of their brands/logos, and may therefore request the landlord only use the brands in their registered form, and in the manner and places approved by the tenant. In Mexico and Japan, the location and type of signage at the store and within the common area are usually specified in the lease documentation.

In practice, there are often advertisement associations between all tenants/occupants in bigger shopping centers. These advertisement associations are typically managed by the landlord or a designated center manager who coordinates the marketing and other advertisement measures for the shopping center, typically on the basis of a pre-agreed marketing plan, but otherwise subject to the wide discretion of the landlord and the center manager. The legal structure and the corporate governance of the advertisement association depend on the applicable law and jurisdiction. In, e.g., Germany and France, advertisement associations are usually structured as civil law partnerships. If there is an advertisement association in place for a given shopping center, tenants are requested to accede to such association and to already grant their general consent to such marketing measures on the level of the lease agreement, including the consent to use their names and/or brand(s) for marketing the shopping center. In particular, major brands are often not prepared to grant such blanket approvals upfront but want to be asked for their prior written approval, on a case-by-case basis, before their names and/or brands are used. In our experience, landlords are often prepared to accept such consent requirements but are reluctant to grant tenants relief from their *pro rata* share of marketing costs in return. In other words, tenants may end up paying for marketing costs, although they prefer not to be named on general advertisements for the respective shopping center and will not benefit from the activities of the marketing association. In France, however, owners of shopping centers are more and more interested in managing their major shopping centers directly, without setting up any organization between tenants/occupants.

XVI. Country-specific Issues

Australia

The distinguishing feature of the Australian retail real estate market is its highly regulated retail lease controls, and the impact of specific retail lease legislation separately enacted across each of the states and territories.

This legislation is presently contained in the:

- Retail Leases Act 1994, New South Wales;
- Retail Leases Act 2003, Victoria;
- Retail Leases Act 2003, Queensland;
- Retail Shops Act 1994, Western Australia;
- Commercial Tenancy (Retail Shops) Agreements Act 1985, South Australia;
- Retail & Commercial Leases Act 1995, Tasmania;
- Fair Trading (Code of Practice for Retail Tenancies) Regulation 1998, Australian Capital Territory; and the
- Lease (Commercial and Retail) Act 2001 and Business Tenancies (Fair Dealing) Act 2003, Northern Territory.

This retail lease legislation has common themes and principles. It does, however, differ slightly across each of the eight jurisdictions. There have been calls to standardize the legislation, as many landlords are national, and retailers increasingly operate on a national chain basis. However, this has not occurred to date.

In each case, the retail legislation comprehensively enshrines certain statutory protections into retail leases, principally for the benefit of retail tenants. The origin of the legislation was the protection of retail tenants that were considered to have little or no effective bargaining power against the several large institutional landlords that dominate the key shopping malls and precincts in the highly securitized retail real estate market in Australia.

The legislation sets out very specific controls on lease terms and the rights and obligations of tenants and landlords in respect of retail leases; and provides a regime of detailed disclosures requirements, principally from the landlord to a tenant, at the commencement and during the course of a retail lease.

The main provisions of the legislation are set out below.

1. Retail Premises to which the Legislation Applies

The legislation provides definitions of retail premises, retail shops and retail shopping centers that come under the protection of the legislation. There are additional provisions that take effect to cover tenancies within retail shopping centers. There are many detailed provisions that prescribe the form that the key terms of a retail lease must take, but the legislation falls short of specifying a prescribed form of retail lease document.

2. Copy of Proposed Lease

The legislation requires that a copy of a proposed retail lease be provided for inspection by prospective tenants. Such a copy may have to be provided in a specific period and form. In most jurisdictions, it must be provided as early as practicable in the negotiations. In certain jurisdictions, the legislation provides for consequences of failing to provide a copy of a proposed lease, including a fine.

3. Disclosure Statements

To comply with disclosure requirements, a disclosure statement with a prescribed form, or one containing prescribed and very detailed information about the tenancy and the premises, must be given to the prospective tenant within a certain period of time before a lease commences.

These disclosures have to be repeated in certain circumstances (e.g., assignment or renewal of the lease).

4. Key Money

The payment of a premium or a nonrefundable amount to a landlord in connection with the grant of a lease, renewal or extension of an existing lease is prohibited.

5. Minimum Lease Term

The legislation provides the term of a retail lease (together with any option term) be not less than five years, except in Queensland, where no minimum lease term is provided. Note that the minimum lease term can be exempted in circumstances where a formal, witnessed waiver is given.

6. Rent Reviews

The legislation imposes the time, basis and formula according to which rent reviews are to be conducted. These rent controls are quite specific, and not only prescribe the forms of rent review but prohibit types of rent reviews that result only in rental increases, and prescribe the valuation process for the determination of market reviews.

7. Outgoings

The legislation provides control of and limits on the pass-through and recoverable costs and restrictions in relation to the calculation of outgoings for retail leases. The legislation also provides list of outgoings that tenants cannot be asked to contribute to.

8. Extension of Lease on Expiry

The legislation also provides a period in which the landlord must notify the tenant whether or not it intends to offer a renewal of a lease at expiry (and, if so, on what terms). If the landlord fails to comply with the notification requirements, the lease may be extended for a specific period.

9. Conduct and Dispute Resolution

Generally, the legislation prescribes that retail landlords must not act unconscionably in their dealings. In the case of a dispute, parties may refer the matter to mediation. More formal procedures for dispute resolution thereafter are subject to requirements by jurisdiction, but generally involve a retail-based dispute tribunal.

10. Additional Documents

The legislation provides that landlords are required to provide to prospective tenants documents relating to the lease (e.g., information brochure, retail tenancy guide and handbook) during the lease negotiations.

11. Fit-out

Generally, a tenant is not required to pay, or contribute toward, the cost of any fit-out, unless the requirement to make a payment or contribution is set out in the disclosure statement.

12. Security Deposits

The legislation provides characteristics of, and mechanisms and requirements for, making security deposits for retail leases.

13. Relocation and Demolition

The legislation provides detailed procedures in a lease to provide for relocation or demolition of a tenant's premises. The legislation also provides certain requirements for the landlord to comply with (e.g., giving prior written notice, offering comparable alternative premises, and giving sufficient details of the proposed refurbishment, redevelopment or extension). Note that the tenant is generally entitled to terminate the lease.

14. Application of the Retail Legislation to the Luxury and Fashion Industry

The carve-out of the application of the legislation to the luxury and fashion industry differs across the various legislations. In some of the major states, the legislation does not apply to corporation tenants that are subsidiaries of listed entities, whether on the Australian Stock Exchange or on foreign stock exchanges. In other jurisdictions, retail premises are exempt if the rent exceeds A$1 million per annum. Other jurisdictions make exemptions for premises in excess of 1,000 square meters in area. Needless to say, the legislation has mixed application to the luxury and fashion industry across the key markets in Australia.

Belgium

Retail lease contracts are governed by the Belgian Act on commercial leases of 30 April 1951 (the Act), most provisions of which are mandatory.

The main features of the Act can be summarized as follows:

1. Scope of the Act

A commercial lease is defined as a lease relating to a retail trade or a craftsperson's business in direct contact with the public, and covers premises used by the tenant for the solicitation of his or her customers (basically, retail outlets and selling or service points).

2. Duration

a. Nine-year Term

In order to reflect the investment made by the tenant in developing an outlet, and in view of the role the leased premises play in attracting the tenant's clientele, the law has fixed the duration of any such lease at a minimum of nine years.

At the expiration of the term of the lease, if the tenant is allowed to stay in the premises, while the lease has not been renewed or extended, there will be a new lease agreement of an indeterminate period. The landlord may terminate the lease at any time, subject to a notice period of at least 18 months.

b. Three-year Early Termination Right

The tenant has the right to terminate the lease agreement at the end of each three-year term, subject to a notice to be served to the owner by registered mail, or by bailiff, at least six months prior to the end of such three-year term. This right is available even if it is not provided in the lease agreement. Pursuant to case law, such rule is mandatory, so it is *not possible* to change it, nor render the exercise by the tenant of its early termination right more burdensome (e.g., by imposing financial penalties, such as indemnities or keeping the bank guarantee amount).

On the other hand, if specifically provided for in the lease agreement, the owner may also terminate the agreement at the end of each three-year term, but only for personal occupation by the owner or closely related persons or entities.

c. Right of the Tenant to Apply for Three (Nine-year) Consecutive

Renewals

The tenant has the right to apply for and obtain renewal for three consecutive nine-year terms. The tenant will therefore have a basic right to maintain a commercial lease for a period of 36 years (if the first term of the lease is nine years) through timely notification of the renewal request. The tenant may file the request for the renewal of the lease, by registered letter or by bailiff, from the 18th month and until the 15th month preceding the end of the current lease period. Such a request for renewal must contain certain information fixed by the Act, failing which the request shall be considered null and void.

Notwithstanding the above, the owner may preclude the renewal of the commercial lease under certain conditions at the end of the ninth, 18th or 27th year. The most typical conditions would be where: (i) the owner has received a better offer from a third party willing to take on a lease of the premises, and the tenant has not validly sent a counter-offer matching the conditions offered by that third party; or (ii) the owner has decided to rebuild the building or the leased premises. The owner can also counter-offer conditions other than those proposed by the tenant in his or her renewal request.

If the parties do not agree, the matter in dispute will be litigated before a justice of the peace. For instance, with regard to discussions of rent, the justice of the peace will take into account prices that are standard in the area or the region for comparable real estate and the special nature of the commerce. He or she shall not take into account the positive or negative return on investment of the business, which is exclusively due to the tenant. The offer of the third party shall only be an element that can be withheld, provided the third party agrees to pay to the tenant the exit indemnity.

Where the owner does not renew the commercial lease, he or she must then pay the tenant a sum equal to one year's rent or up to three years' rent, depending on his or her reasons for refusing the renewal. The indemnity for the refusal of renewal is equal to:

- one year when the landlord wishes to use the property for a use other than commerce or rebuilding;
- two years of rent when the commerce performed in the premises by the landlord shall be the same as the one previously performed by the tenant;
- three years (increased with possible damage caused) if the landlord does not perform the intention communicated to the tenant when the renewal was refused within six months and for a period of at least two years from the end of the lease;
- one year of the rent stated in the new lease if a reasonable offer from the tenant has been refused due to a higher offer of a third party, and the third party performs another trade in the premises;
- two years of the new rent when the new tenant performs the same trade; and
- three years of rent (increased with possible damages) if the landlord or the new tenant starts a similar trade before the end of two years without having informed the tenant thereof. Both the landlord and the new tenant shall be jointly liable for this indemnity.

3. Rent Adaptation – Rent and Market Rental Review

a. Yearly Rent Adaptation

Pursuant to article 1728*bis* of the Belgian Civil Code, rent may be reviewed once a year, on the anniversary of the starting date of the lease, pursuant to the health index, using the following formula:

Reviewed rent = initial rent X new index (index of the month preceding the anniversary of the starting date of the lease)/base index (index of the month preceding the date of signature of the lease).

b. Rent and Market Rental Review

Before the end of each three-year period, each party may file a petition to revise the rentals to be paid by the tenant under the agreement if, due to new circumstances, the normal rental value of the property has increased or decreased by more than 15 percent of the rentals, as established in the lease or in the last revision.

Such a petition must be filed with the competent justice of the peace in the course of the three-month period preceding the end of each three-year period.

4. Assignment

An assignment of the lease agreement (or a subletting of the premises) by the tenant is, in principle, allowed if the business itself is transferred together with the lease agreement. However, the owner may object to such transfer for "good reasons".

It must be noted that, even in the case of such an assignment (or subletting), the initial tenant remains jointly and severally liable with the assignee/subtenant for all the obligations toward the owner resulting from the lease agreement.

5. Works to the Rented Premises

According to the Act, a statutory right exists for the benefit of the tenant for performing any modification that could be useful for its business in the rented premises, provided that:

- the cost of these works does not exceed three years of rent;
- these works do not affect the security, stability or aesthetic aspects of the building; and
- a prior notice containing the plans and an estimate is sent to the owner by registered letter, in order to give him or her a chance to oppose it. The owner is deemed to agree with these works if no reaction is given within a 30-day period after the reception of the tenant's notice.

At the expiry of the lease agreement, the works and alterations to the rented premises may remain in place and will become the property of the landlord (in which case the landlord will have to reimburse the value of the materials and the labor, or pay an amount equal to the added value to the building), except if agreed otherwise in the lease contract.

Brazil

1. Letters of Intent

A letter of intent (head of terms) is commonly used in Brazil. However, it is often negotiated by the client directly or through real estate brokers, with no, or limited, involvement by lawyers. A letter of intent usually has a limited time period in which it is applied, and may be conditional or not legally binding (though nevertheless respected by the parties).

A letter of intent includes the most basic commercial terms, such as premises, rent, rent-free periods, security, indexation, commencement date, term, break options and prolongation options.

The usual exclusion of legal advice at this early stage makes negotiations regarding particular terms of the lease contract more complicated and time consuming, as numerous significant legal and commercial issues, such as early access, termination reasons, rent discounts, penalties, damages, services and service charges payments, may be omitted from the letter of intent.

2. Rent and other Lease Payments

Rent for retail premises is usually triple the net rent.

A combination of basic and turnover rent is used for leases in shopping centers. Basic rent is adjusted for inflation on a yearly basis through the use of official indexes (with the General Price Index (GPI) used most frequently).

All expenses and management costs (including insurance, marketing and administrative costs) are re-invoiced to tenants (the extent may depend also on the position of the tenant), the amounts being calculated proportionally to the size of the lease area.

The tenant is also usually responsible for the day-to-day maintenance of the premises.

Caps are largely opposed by landlords, and so caps on service charges are unusual. However, caps on minor maintenance are acceptable in certain cases.

3. Incentives and Key Money

An initial rent-free period and eventual fit-out contribution (even during the entire lease term) are standard tenant's incentives.

Key money is not unusual in the retail industry in Brazil, particularly for leases in shopping centers. In most cases, payment is construed as a reimbursement of the landlord's initial investments in the leased site (such as design projects' costs) and subject to a separate agreement. Key money is not considered additional rent.

At the tenant level, key money is considered an expense, which is spread over the duration of the lease.

Landlords very often obtain, through negotiation, payment of lump-sum key money by the new tenant to be able to lease the retail space. The key money represents the value attributable to the location of the site. Often, the landlord will require payment by the new candidate tenant of lump-sum key money in addition to the rent, fees and services charges payable under the lease agreement.

4. Flexibility in Leases

Assignment and subletting is permitted only with the prior written consent of the landlord. However, assignment and subletting to a group company is often permitted, based on the parties' agreement.

Brand exit is usually not regulated in the lease agreements, and there is no applicable statutory provision. A lease for a definite period may not be terminated by the landlord for convenience; however, the tenant may terminate the lease upon prior notice and payment of the penalty agreed under the lease (or fixed by a court if the lease is silent in that respect).

The permitted scope of use is generally a highlighted and restricted issue of the lease agreement and, usually, the tenant may only change the scope of the use with the prior consent of the landlord.

5. Key Operating Standards

It is usual to provide obligations to trade in leases for retail premises in commercial centers. This includes an obligation on the tenant to comply with opening hours, and join a tenants' association, to be part of promotional campaigns.

Restrictions on competitors and exclusivity provisions need to be negotiated on a case-by-case basis and agreed in the lease.

Staffing and stocking are not usually limited by the landlord. It is usual, however, to specify in leases for retail premises in commercial centers that the sales surface area shall not exceed a maximum surface area.

6. Tenancy Fit-out Issues

The fit-out is typically done by the tenant.

At handover, the premises are usually delivered in concrete shape without any fit-outs.

Certain fit-outs may require prior public approvals: in particular, construction permits (prior to the commencement of works).

Typically, the design and fit-out are subject to the landlord's approval, which must not be unreasonably withheld. Alternatively, the fit-out plans are attached to the lease and approved by the landlord. It is also quite common that nonstructural alterations (like the interior fit-out) be permitted to the extent that they do not affect the structural integrity of the building.

7. Damage and Destruction

If damage or destruction render the continued use of the leased premises almost impossible, the lease agreement would be automatically terminated, unless the lease agreement provides otherwise.

If the damage or destruction does not significantly affect the use of the premises, the lease would continue in accordance with its provisions, unless otherwise provided. Brazilian lease law provides that in the event the landlord needs to undertake repairs to the premises, the tenant must allow such repairs without any indemnity or rent rebate, except when the repair works continue for at least 10 days, in which case the tenant would be entitled to a rent rebate. The tenant may terminate the lease if repair works continue for 30 days or more. Very often, a lease will contain specific provisions deviating from these rules, either to improve the position of the landlord or, alternatively, the legal position of the tenant.

8. Limited Liability

The landlord is liable for structural defects of the leased premises and shall repair any such defect. However, the landlord is normally not liable for the interruption of services provided by third-party service providers (e.g., public utility services).

9. Specific Issues

Leases in Brazil are governed by the law number 8.235 dated 18 October 1991, which regulates residential, commercial and industrial leases, and subsidiarily by the Brazilian Civil Code.

Under Brazilian lease law, when a lease exceeds five years, the tenant has the right to an automatic renewal of the lease (if some conditions are met: i.e., the tenant will maintain the purposed use of the leased premise) and cannot be removed from the leased property, except in the case of specific defaults. The rent for the lease extension is negotiable and if the parties cannot agree on the amount, it will be determined in court.

If the leased premises are to be sold, the tenant has the legal right of first refusal (unless the right was waived under the agreement). If the tenant does not exercise such a right, the new owner of the real estate must honor the lease agreement if the following requirements are met: (i) the agreement establishes that it shall continue in force in the event of sale to third parties; (ii) the agreement was entered for a fixed term; and (iii) it is registered with the relevant Real Estate Registry.

The law also provides for different types of collateral – a landlord may request as security for a tenant's compliance with the agreement (unless the rent is paid in advance): (i) a deposit equivalent to the maximum of three rents to be deposited into a savings account during the term of the lease; (ii) a personal guarantee extended by an individual or an entity (this may be replaced by a bank guarantee); or (iii) an insurance policy covering compliance with the tenant's obligations. The law does not permit more than one type of collateral for the same lease agreement.

Further, there are typically four documents associated with the landlord-tenant relationship as regards the ruling of the use of private and common areas in a shopping center: (i) the Declaratory Deed of General Norms Regulating the Functioning, Utilization and Lease of the Shopping Center; (ii) the Internal Rules of a Shopping Center; (iii) the Shopkeepers' Association rules; and (iv) the specific lease between the landlord and the individual tenant.

The Declaratory Deed governs the development, construction and basic operating rules of the center, and is registered with the incumbent notary registry. A registered Declaratory Deed has priority over all subsequent documents such as individual leases, whether such leases are registered or not. If there is a conflict between the Declaratory Deed and the individual lease, the clause in the Declaratory Deed takes preference, unless the lease specifically references the conflicting clause and specifies the difference. It is not sufficient to state a general clause in the lease that in the case of conflict between the two documents, the lease clause applies. For the clause to apply, each conflicting clause must be specifically enumerated and referenced in the lease.

England and Wales

1. What Laws Regulate Retail Leasing?

Retail lease agreements are regulated, like all other real estate leases, by statute and English common law principles. The key statute regulating all leases is the Landlord and Tenant Act 1954 (the 1954 Act).

There are no nationality restrictions on holding a lease, and there is no distinction between UK and foreign nationals in the process of securing retail space.

2. Use of Letters of Intent

Letters of Intent (usually known as heads of terms) are commonly used in England and Wales. They are usually negotiated by real estate agents, and lawyer involvement is low – though advisable, if possible.

They are usually nonbinding, other than their confidentiality and exclusivity provisions, if specifically stated.

Heads of terms include the basic economic and commercial terms, such as premises, rent, rent-free periods, security, indexation, commencement date, term and break options. They vary in the level of detail included. The more detail that can be included (with lawyer involvement) the better, as while they are, in the main, nonbinding, it can become more difficult to negotiate key issues at a later stage if they have not been agreed in the heads of terms. Any brand-specific requirements should be flagged at this stage.

3. Agreements for Lease and Leases

It is very common for parties to enter into an agreement for lease prior to the main lease agreement. An agreement for lease is a binding document that requires the tenant to take the lease after the occurrence of specific events: usually, the landlord gaining vacant possession and/or carrying out some landlord's works. If key monies are payable, a 10 percent deposit is usually taken. This is returnable if the conditions are not fulfilled. A longstop date, by which time the conditions must be fulfilled, is usually agreed.

The agreement for lease sometimes provides for early access for the tenant to start its fit-out works.

Once the conditions are fulfilled (i.e., the landlord's works have been completed), the main lease agreement will be signed and completed. Completion occurs, and the lease becomes legally binding, on the day the lease is dated, not the date of signing. The tenant's lawyers hold the signed documents in escrow until dating.

It is usual to sign the documents in counterpart and for each side's lawyers to hold their own client's signed copy. The originals are then swapped upon completion.

4. What are the Specific Key Retail Lease Issues?

a. Rent and other Lease Payments

Rent is usually triple the net rent, which is known as a fully repairing and insuring (FRI) lease on an institutional lease.

In shopping centers, it is usual to see turnover rents payable over and above basic rent. Basic rent is usually then adjusted in line with the Retail Prices Index on a yearly basis.

Five-yearly upward-only rent reviews are the most common.

All expenses and management costs (including insurance, marketing and administrative costs) are usually covered by the tenant under a service charge.

The tenant is responsible for business rates. Properties are assessed on the basis of their annual rental value on a fixed valuation date, using assumptions fixed by statute.

b. Term

There is no maximum or minimum term by law. Standard retail leases tend to be between five and 10 years.

The 1954 Act grants to a tenant the right to call for a new lease at the end of the original term of years, unless the landlord objects to such renewal and demonstrates to the court's satisfaction that it should not be granted.

There are a limited number of grounds on which a landlord may object to a renewal, and it must prove such ground(s) to the court's satisfaction. One such ground is that the landlord wishes to redevelop the property at the end of the term. Another is that the landlord wishes to occupy the premises for its own business at the end of the term.

However, increasingly, parties agree at the beginning of the lease that the tenant will not enjoy the security of tenure protection offered by the 1954 Act. The effect of this is that the lease automatically expires at the end of the original term, with no right for the tenant to renew. The parties must follow a simple statutory procedure in order to exclude the lease from the provisions of the 1954 Act.

A break clause can be negotiated for either party, but is less common in retail leases.

c. Incentives and Key Money

Initial rent-free periods and fit-out contributions are standard tenant's incentives.

Key money (also known as a "premium") is often seen in the luxury sector, for flagship store locations, such as Bond Street and Oxford Street in London. It is rare in shopping centers.

d. Flexibility in Leases

Assignment and (less frequently) subletting are usually permitted only with the prior written consent of the landlord.

There are rarely any changes to control provisions, but provisions stating that only the tenant's brand may operate in the premises under the agreed brand names are frequently seen.

e. Trading

Leases for retail premises usually include "keep open covenants" (i.e., an obligation to trade). This is very usual in shopping centers where turnover provisions apply, but is also the case in prime locations.

Restrictions on competitors and exclusivity provisions need to be negotiated on a case-by-case basis and agreed in the lease.

Opening hours are often set out in leases, particularly in shopping center ones, but are generally governed by local municipality laws.

f. Decoration

It is usual to include provisions that internal and (if relevant) external redecoration must be carried out by the tenant every five years.

g. Yielding Up at the End of Term

The premises usually have to be handed back in a full state of repair, with all the tenant's fixtures and fittings removed.

h. Fit-out

The fit-out is typically done by the tenant.

At handover, the premises are usually delivered in shell and core.

Fit-out works often require planning permission from the local council, prior to the commencement of work.

Typically, the design, fit-out and signage are subject to the landlord's approval, which must not be unreasonably withheld.

i. Alcohol Products

Luxury brands may wish to serve alcohol (such as champagne) to clients. If the store is selling alcohol, a premises license is needed, as well as an appointed supervisor who has a personal license. An application to the local municipality will need to be made and the cost is dependent on the ratable value of the property.

If the retail store is giving away alcohol, it will not need to apply for a license, provided that a customer is not under an obligation to purchase something in order to get a free drink.

If soft drinks are sold, these are technically classified as food, so the store would need to register as a food business with the municipality. If food is given away, the municipality may need to be alerted, so that food safety officers can do a risk assessment.

5. What Taxes Affect Retail Leasing?

There are no special taxes for retail leases. The following taxes are, instead, applicable (as under other real estate leases):

Value-added tax (VAT), which is currently at 20 percent, is applicable to certain rental payments under a retail lease agreement, where the landlord has opted to tax. Most retail leases are therefore subject to VAT, but there are some exceptions.

Stamp duty land tax (SDLT) is charged on land and property transactions in the UK. The tax is charged at different rates, and has different thresholds for different types of property and different values of transaction. There is an SDLT charge of 1 percent of the net present value of the rent over the term, where this exceeds GB£125,000, and there is also an SDLT charge on any key money as follows:

Up to GB£150,000 – annual rent is under GB£1,000	Zero
Up to GB£150,000 – annual rent is GB£1,000 or more	1%
Over GB£150,000 to GB£250,000	1%
Over GB£250,000 to GB£500,000	3%
Over GB£500,000	4%

This is payable within 30 days of occupation.

6. Registration

Leases over seven years need to be registered at the Land Registry, and a small registration fee will need to be paid.

7. Security

It is usual for a landlord to require some form of security. This can be in the form of a parent guarantee (if the parent company is based overseas, a legal opinion on their standing and legality is almost always required), a rent deposit deed or a bank guarantee.

France

1. Duration, Termination and Renewals

In France, retail lease agreements, like all commercial lease agreements, are governed by two different sets of rules stipulated under the French Commercial Code and the French Civil Code and that are, generally speaking, favorable to tenants.

The French Commercial Code governs the duration, renewal and termination of commercial lease agreements, rent review, use of the premises, subletting and assignment, while general terms of commercial lease agreements, such as maintenance and repairs, are governed by specific provisions of the French Civil Code (see below).

The duration of commercial lease agreements cannot be less than nine years, but the landlord and tenant can provide for a longer term. For instance, the term of retail lease agreements for premises in shopping centers is usually 10 years, so that rent can be fixed at market value upon renewal. If the term is more than 12 years, however, it must be registered with the Land Registry, thus triggering specific costs (notary fees, registration duties and Land Registry fees).

The French Commercial Code also allows short-term leases not exceeding three years. These short-term leases, which are outside the scope of regulations on commercial lease agreements, are governed only by the general provisions of French Civil Code applicable to lease agreements. These short-term leases are usually entered into when companies want to test their concept before entering into a commercial lease agreement of nine years, or open so-called “pop-up stores” at specific street locations.

Unless specific conditions are met, the landlord cannot terminate a commercial lease agreement during this nine-year period. On the other hand, the tenant benefits from a triennial right of termination (through the delivery of a notice to quit by process server six months in advance) but may contract out of such a triennial right of termination. This is usually the case when the landlord grants to the tenant a rent-free period or contributes financially to the tenant's fit-out works.

Upon expiry, the tenant benefits from the right to obtain a renewal of its commercial lease agreement, and the landlord cannot refuse to grant such renewal without paying to the tenant compensation for eviction, the cost of which can be substantial. This so-called security of tenure is an essential aspect of French regulation of commercial lease agreements.

Following a law dated 18 June 2014, this security of tenure is now granted to foreign companies or individuals without limitations (subject, however, to registration at the relevant Commercial and Companies Registry of the business operated in the rented premises).

2. Rent Structure

The initial rent is fixed by parties before signature upon the execution of the lease. It generally corresponds to the market price for such premises and is usually paid quarterly in advance. For retail lease agreements for premises in shopping centers, the rent is usually structured through, on the one hand, a minimum indexed rent and, on the other hand, a percentage of turnover made in the rented premises. This is more rarely the case for retail premises in street buildings.

Parties to commercial lease agreements are free to stipulate that rent shall be indexed on an annual basis. However, under French law, such indexing will be only valid if it is directly related to the object of the contract or to the activity of one of the parties. Until recently, the index that was usually chosen for commercial lease agreements was the National Cost of Construction Index (*L'indice du coût de la construction* (ICC)). Other indexes created over the past few years were an alternative to the ICC: the Commercial Rents Index (*Indice des Loyers Commerciaux* (ILC)) for commercial activities, and the Index of Rents for Services Activities (*Indice des loyers des activités tertiaires* (ILAT)) for services activities. Following the law dated 18 June 2014 mentioned above, the ICC will no longer be valid for commercial lease agreements entered into or renewed from 1 September 2014; parties will have to use the ILC.

In addition to this yearly rent review, the rent of commercial lease agreements may be reviewed by the landlord or the tenant every three years during the lease term. Upon renewal, and depending on the case, increases in rent may be capped or rent may be fixed at market value. The law dated 18 June 2014 mentioned above will significantly modify the regulations applicable so far to commercial lease agreements by providing for a cap on rent increases during the lease term or upon renewal.

3. Key Money

Upon the execution of leases, it is not unusual for tenants of retail premises located in performing shopping centers or top-located street buildings to pay landlords key money. Payment of this key money will be deemed compensation to the landlord for the security of tenure granted to the tenant, as mentioned above, or for the cap mechanism in rent reviews benefiting the tenant, as mentioned below.

4. Allocation of Obligations and Service Charges

With respect to basic obligations of landlords and tenants, landlords are usually required to repair and maintain the structure of the rented premises (these repairs are usually referred to as major repairs in article 606 of the French Civil Code) and insure the rented premises, while tenants are usually required to pay rent and service charges when they are due, keep the rented premises in good maintenance and repair order, and insure their belongings, merchandise and goods within the rented premises.

However, it is not unusual (especially for retail premises in shopping centers) for the tenant to bear all service charges, expenditure and taxes relating to rented premises, with the landlord receiving a rent net of all taxes, contributions, charges and expenses.

Once again, the law dated 18 June 2014 mentioned above will significantly modify solutions applicable so far by limiting the scope of repairs, expenses and taxes incurred by landlords, which can be re-invoiced to tenants through service charges. A decree listing repairs, expenses and taxes that, by reason of their specific nature, can no longer be re-invoiced by landlords to tenants is to be enacted within the coming weeks.

5. Assignment and Subletting

For flexibility reasons during the lease term, retailers must pay attention to assignment and subletting provisions.

Pursuant to the provisions of the French Commercial Code, exclusion of the right to assign a commercial lease agreement is void to the extent that it prevents a tenant from assigning its lease to the purchaser of its business. A provision excluding such a right to assign will therefore only be valid when the assignee does not purchase the business carried out by the assignor in the rented premises. Commercial lease agreements may nevertheless provide that the right of the tenant to assign the lease is subject to the prior approval of the landlord. This is usually the case for retail leases for shopping centers where landlords want to manage the merchandising mix. With respect to subletting, and unless the commercial lease agreement provides to the contrary, any subletting, whether of the whole or parts of the rented premises, is prohibited. Tenants usually insist on being granted (and are usually granted) the right to sublet part of the premises to companies within their group.

6. Technical Reports

Finally, there is an increasing number of technical reports that have been created over the past few years and that must be attached to commercial lease agreements and/or communicated to tenants.

An energy efficiency report, which states the quantity of energy used, or to be used, according to the type of use of the building, has been created. This report is to be communicated by landlords to tenants.

A technical audit record, to bring together information (statements, reports and audits) relating to the safety of the buildings, as well as the health and safety of the occupants, has also been created. Notably, this shall include a statement referring to the presence/absence of construction materials/products containing asbestos, and a risk statement in zones within the perimeter of a plan for prevention of risks or in an earthquake zone.

A specific annex dealing with environmental matters, such as the consumption of electricity and water, is also to be attached when the surface area of the rented premises exceeds 2,000 square meters. There is an increasing trend among landlords of shopping centers to attach such an annex to retail leases for premises with smaller surface areas.

Germany

Generally, lease provisions (including retail leases) are freely negotiable in Germany. When negotiating a retail lease, statutory lease law, which is mainly governed by the German Civil Code (*Bürgerliches Gesetzbuch* (BGB)) will apply, unless agreed otherwise in the lease. Generally speaking, German lease law is more favorable to the tenant, which is why landlords usually try to shift as many responsibilities to the tenant as is legally possible and practicably and/or commercially feasible. In addition to the statutory lease law, there is an extensive body of case law. This consists of the rulings of the German Federal Court of Justice (*Bundesgerichtshof*) and the German Higher Regional Courts (*Oberlandesgerichte*) affecting the validity and enforceability of the provisions in retail leases.

Further restrictions apply if the lease provisions qualify as general terms and conditions; if they do, they are subject to particular scrutiny, and have to comply with a specific set of statutory provisions and case law to be valid. These restrictions mainly apply to standard residential leases, but may also influence the validity of standard clauses in retail leases that need to be taken into account when drafting the lease agreement.

Like other leases, retail leases may have an indefinite term, subject to termination within the statutory or contractually agreed notice periods. Generally, fixed terms must not exceed 30 years. A lease agreement providing for a fixed term of more than 30 years will be deemed a lease having an indefinite term after 30 years. The 30-year period is calculated from the day on which the lease term has been agreed or the last time it has been amended. It is, therefore, possible to extend the term of an existing lease for a further 30 years. Hereditary building rights are not subject to any restrictions as to their term.

German mandatory law provides that each lease agreement may be terminated by either party for cause. Generally, a lease can be terminated if the other party is in material breach of contractual obligations. Further restrictions apply to the termination of residential leases and termination due to insolvency.

The term of a retail lease may also be affected if it does not comply with the strict form requirements applicable to commercial leases entered into under German law, pursuant to which a commercial lease with a fixed term of more than one year must be concluded in "written form". If this requirement is not met, the lease may be terminated by either party, regardless of the agreed term, by observing the statutory notice period for commercial leases, which is basically six months from the end of a calendar quarter.

The following issues may result in a breach of the written form requirement: (i) there is no physical connection between all pages and annexes of the lease, or no clear reference between all pages ensuring such a clear connection; (ii) the lease is not duly executed at the bottom of the agreement; (iii) the lease is not duly signed by the authorized signatories; (iv) the lease does not contain all material arrangements between the parties regarding the leased space (e.g., due to the existence of any side letters); and (v) the most recent amendment agreement to the lease has any of the defects listed above, or does not include clear reference to all former amendment agreements and to the lease agreement itself.

The German Price Clause Act (*Preisklauselgesetz*) prohibits an automatic indexation of monetary obligations. As an exception to this rule, rents under commercial leases having a term of at least 10 years may be linked to the consumer price index (*Verbraucherpreisindex*) published by the German Federal Statistic Office on a monthly basis, which is typically done with the base rent in retail leases. Sometimes, retail leases provide for stepped rent or a lease review clause to adjust the rent to a fair-market level at the time of renewal or extension.

Hong Kong and China

1. Models for Multijurisdictional Rollouts

Hong Kong and China's first-tier cities (Beijing, Shanghai, Guangzhou and Shenzhen) are attractive destinations for international retailers. Many international retailers already have shops in Hong Kong and China's first-tier cities. Recently, more international retailers have been entering the market in China's second-, third- and forth-tier cities and are expanding there.

International retailers' entry into the market creates increased competition for older, established retailers. Prime locations are sought after by retailers, and rents are driven up by the increased demand. The increase in rent leads to lower profitability for retailers. The older, established retailers that cannot afford to pay high rents may either be forced to relocate to less-prominent locations or to close down.

Hong Kong retail space commands some of the highest rents in the world, due to sustained large demand and limited new supply. Much of Hong Kong's retail space is occupied by international brands, including high-end fashion, watch and jewelry stores.

Despite record-high rents, international retailers continue to target core shopping centers and high-street shops as locations for new concept and flagship stores, in order to take advantage of both robust tourism generally and deep-pocketed locals from Hong Kong and mainland China.

The situation is much the same with regard to retail space in China's first-tier cities. The influx of high-end international brands has increased competition for prime retail space, leading to high rents and landlord-friendly leases becoming the norm.

In China's second-, third- and forth-tier cities, the demand for retail space is not as strong. There is greater equality of bargaining power between landlords and tenants and, consequently, rents are generally lower and leases not so heavily weighted in favor of the landlord. Nonetheless, with continued economic growth and brands undertaking aggressive global expansion policies into new and emerging markets, the state of the leasing market in second-, third- and fourth-tier cities is moving closer to that of Hong Kong and first-tier Chinese cities.

2. Key Country-specific Retail Lease Issues

Due to the high demand for, and limited supply of, retail space, leases in Hong Kong and first-tier Chinese cities are very landlord friendly. The following clauses, which have all been introduced by major landlords in Hong Kong and first-tier Chinese cities in recent years, reflect the status quo:

a. Prescribed Lease Form in China

Some provinces in China have their own prescribed form of lease for landlords and tenants to adopt. The prescribed form of lease is generally tenant-friendly. However, most landlords will prepare a supplemental agreement to replace or vary specific clauses in the prescribed lease.

b. Reviews of Base Rent and Turnover Rent

Rent under a retail lease will often be made up of a fixed base rent, in addition to a turnover rent calculated as a percentage of the tenant's turnover. The base rent is usually subject to review periodically (e.g., at the commencement of the renewed term) by reference to a valuation of comparable premises. Unlike base rent, turnover rent is usually agreed at the outset, but, in rare cases, turnover rent can also be subject to review.

By contrast, up until recently, the specified percentage of turnover payable as additional rent would remain the same throughout the term and not be subject to review. However, it is increasingly common for landlords to require that turnover rent, as well as base rent, be subject to periodic review, generally on an upwards-only basis.

c. No Deduction of Income from E-commerce

Not only is it becoming more common for turnover rents to be reviewed, the methodology for calculating turnover has changed. Some landlords are insisting that the definition of turnover, for the purposes of calculating turnover rent, include not only receipts taken at the property but also all e-commerce-related turnover. This has the effect of increasing a tenant's turnover figure and therefore increasing its turnover rent.

d. Sales Targets

Retail leases may provide that the tenant must meet certain specified sales targets. Failure to meet such targets entitles the landlord to terminate the lease.

e. Radius Clause

Retail leases may place restrictions on the tenant's freedom to open new stores within a certain radius of the premises.

f. Marketing Requirements

Pursuant to the lease, tenants may be under an obligation to use their best efforts to market the landlord's premises, and potentially even treat it as their flagship store. Clauses of this nature require the tenant to carry out store-specific marketing in addition to general brand promotion.

g. Periodic Redecoration

In addition to any obligations to keep the property tidy and in good repair and condition, a tenant may also be under an obligation to periodically redecorate or refurbish the store to the satisfaction of the landlord, and at the tenant's own cost.

h. Termination for Sale or Redevelopment

Clauses that allow the landlord to terminate a lease where it resolves to sell, demolish or redevelop the property are becoming increasingly common. The only restriction on the landlord's ability to exercise such rights will relate to the required notice period. Where the lease is terminated pursuant to a planned sale or redevelopment, the tenant has no right to object, nor any right to compensation. This can lead to uncertainty and unfairness for tenants, particularly where a tenant has spent money fitting out the property, as this expenditure will not be recoverable once the lease has been terminated.

i. Prohibition on Assignment

Leases usually prohibit subletting or assignments to third parties. Consequently, tenants are bound by the lease for the whole of its term, leaving them with little flexibility should the needs of the business change. This inflexibility is compounded by the fact that it is unusual for leases to include a tenant's break clause.

j. Relocation

Leases of retail premises may entitle the landlord to relocate the tenant to another premises within the same shopping center. The tenant has no right to object, nor any right to compensation, if it is required to relocate. Again, this creates uncertainty, as the tenant may, at the landlord's discretion, be relocated from premises in a prime location to less-desirable and less-prominent premises within the shopping center. It also gives rise to the possibility of the tenant having to incur additional costs fitting out the new premises.

k. Store Opening Date

Leases of retail premises may specify a date by which the tenant must commence business there following a period for the fit-out. Particularly in new shopping centers, a landlord will want to coordinate the dates to ensure that all stores open for business on the same day. This deadline puts pressure on tenants to complete their fit-out as soon as possible in order to comply with the specified opening date.

l. Brand and Merchandise Requirements

Leases of retail premises may specify that a tenant shall only sell from the store products under a certain brand name. Furthermore, it may specify not only the brand but also the types of items that may be sold from the store. This is another example of landlords in Hong Kong and China having significant control over not only a tenant's use of premises but also its retail operations.

m. Brand Protection

Some landlords may insist on the inclusion of a statement that it is under no obligation, and accepts no responsibility, in respect of any parallel imports or counterfeit goods sold by any other tenant of the landlord within the shopping center. It will be the tenant's responsibility alone to police the sale of parallel imports and counterfeit goods by other tenants of the landlord.

n. Anti-corruption

Many international retail tenants are subject to laws of their own country relating to bribery, corruption, fraud and money laundering (e.g., the U.S. Foreign Corrupt Practices Act (FCPA)). However, landlords are increasingly resisting the insertion of clauses that, first, confirm the landlord recognizes that the tenant is subject to such laws and, second, require that the landlord refrains from engaging in any actions that would violate the anti-corruption legislation.

3. Adapting to Local Jurisdictions and Customs

Leases in Hong Kong are drafted in English and the language used is generally of good quality. However, leases in China are written in Chinese and can be of variable quality. An English translation may be provided, but, in practice, the translations are often poorly drafted.

4. Local Taxes and Cost Consideration Issues for Retail Presence and Documentation

Stamp duty is payable on Hong Kong and China leases. The level of stamp duty depends on the rent payable and the length of the tenancy. In China, stamp duty rates vary between cities.

The landlord and the tenant are both obliged to pay stamp duty. In most cases, the parties will pay the stamp duty in equal shares.

5. Key Licensing and Retail Presence Approval Issues

Tenants in both Hong Kong and China require business licenses to operate retail stores. In Hong Kong, obtaining a business license is, for all intents and purposes, a formality requiring the completion of forms and payment of a license fee. Typically, tenants in Hong Kong do not require any industry-specific licenses (in addition to a business license) except in special circumstances. This contrasts with China, where the requirements of obtaining business licenses and industry-specific licenses are more stringent.

Furthermore, unless the tenant intends to carry out major fit-out works involving structural alterations in Hong Kong, there is generally no requirement for any approval from local authorities. However, in China a more stringent approval process for alterations applies.

6. Use of Tenant Representatives

It is the norm in both Hong Kong and China for tenants to use an external real estate agent or have an in-house representative look for suitable premises and conduct lease negotiations on their behalf. The authority of the agent or the representative must be clearly defined, so as to ensure that the agent or the representative does not act beyond the scope of his or her authority.

Italy

The main feature that characterizes the Italian market when it comes to retail leasing is that there are basically two different ways to obtain an available retail space:

i. the more traditional way, which is through the execution of a *lease agreement*; or
ii. through the execution of a "*lease of business*" agreement – *Affitto di ramo d'azienda*.

The main difference between a lease of premises and a lease of business is that, in the latter, the object leased includes not only the premises but also other elements, among which is essentially the trading license. The availability of the spaces, the trading license and, possibly, other elements (such as permits and all the common facilities available in a shopping center) make up the concept of the business ("*azienda*") that is leased to the tenant.

The lease of business, as opposed to a lease of premises, has traditionally been used in shopping centers/outlets, but it is becoming more and more common also for high-street flagship stores. This is a consequence of historic centers typically having restrictions on granting new trading licenses for shops and, therefore, the structure of a lease of business also being of interest to tenants. Otherwise, tenants would typically prefer the structure of a lease of premises, since (save as indicated in the following paragraph) said contracts are subject to Law No. 392 of 27 July 1978 (Law 392). Law 392 is very favorable to the tenant, as it has the benefit of mandatory provisions affecting duration, renewal, rent reviews, pre-emption rights, goodwill indemnity, tenant's right to terminate, etc. In contrast, when using a lease of business structure, the parties are not bound by the provisions of Law 392. This allows them to freely agree on all the terms of the agreement, except for general provisions of Italian law. This is why this type of deal structure is mainly preferred by landlords, who, in using it, can avoid the mandatory provisions of Law 392.

On 12 November 2014, the Law 164/2014 liberalizing significant commercial leases came into force in Italy. The law provides that the parties to a lease of premises are no longer subject to the provisions of Law 392 and are, therefore, free to determine the provisions of the lease as they wish, if the following elements are met:

i. The lease is for non-residential use, including leases for hotels.
ii. The annual rent is higher than €250,000.00.
iii. The lease does not concern "premises qualified of historical interest further to a regional or municipality determination".

Essentially, the parties to a lease that meets the abovementioned conditions acquire total freedom in the determination of the contractual terms, having, e.g., the possibility of: establishing a duration of less than six years; agreeing on increases in rent, independently from the traditional mechanisms of cost-of-living adjustments; excluding the loss of goodwill indemnification; excluding the tenant's right of first refusal for future leases; and differently regulating the tenant's withdrawal right or the renewal of the agreement.

So far, it remains unclear what the legislator intended to capture by using the expression mentioned under point (iii) above: the lease shall not concern "premises of historical interest further to a regional or municipality determination". In the absence of any clarification from the legislator or interpretation from any authoritative doctrine, it is only possible to hypothesize as to the meaning of the wording. One reasonable interpretation might be that the leased premises shall not have obtained recognition from the region and/or the municipality as a “historic store” (*negozio storico* or *insegna storica*). However, for the time being, we cannot even say that the law meant to exclude buildings subject to “indirect constraint’ (i.e., buildings subject to a constraint, which, however, does not trigger the state’s right of first refusal in the event of sale).

1. Use of Letter of Intent

Parties to lease agreements do not often sign a letter of intent (LOI). Very often, the leased premises are owned by private individuals, who are not used to signing such a letter.

Things change if real estate brokers are involved. Brokers very often push the parties to sign LOIs. However, particular care should be taken in reviewing the LOIs proposed by brokers, as they often draft binding proposals, rather than typical LOIs, which are usually not legally binding (except for exclusivity and confidentiality provisions).

Even when an LOI is signed, the involvement of lawyers is very limited. In most cases, lawyers get involved only after the LOI (if any) is signed.

LOIs are more frequent (although not always signed) in the case of a lease of business, as opposed to a lease of real estate.

LOIs typically include the main business terms of the lease (such as rent, free-rent periods (if any), service charges, duration, right of tenant to early termination, improvements/works/fit-out regime, right to expose signs, and allocation of maintenance expenses).

2. When is a Lease Transaction Binding?

Under the Italian Civil Code, the agreement is executed at the moment the party who makes the offer receives the acceptance of the counterparty. However, parties can be legally bound to each other even if no agreement has been signed. If the parties have reached an agreement on all the main aspects of the transaction and one of the parties terminates the negotiations without justification, the other party may claim that an agreement was reached and it is binding upon the parties, although it was not in writing and nothing was signed.

Moreover, during negotiations, the parties have a duty to act in good faith. Therefore, a party cannot unreasonably withdraw from a negotiation. Breach of said duty may result in compensation for damages.

3. Process and Quality of Lease Documentation

Lease agreements are registered with the tax authority within 30 days from execution. If the duration of the lease exceeds nine years, the agreement should be executed before a notary public.

Lease of business agreements should always be executed before a notary public and are public deeds.

4. Key Licensing and Planning Controls

a. License to Trade

For shops having a sale area under 250 square meters, the license to trade can be easily obtained, by filing a simple communication with the municipality. For larger shops, the authorization procedure requires more time and there might be restrictions (imposed by local authorities; i.e., the municipality) on the granting of said authorizations (this is typical for historic centers). It is advisable to gather specific information with respect to the possibility of obtaining a trading license before entering into a lease agreement. Also, for this reason, retail spaces are often leased through leases of businesses rather than leases of spaces, because the business will also include the authorization/license to trade in that specific space.

b. Obligation to Trade

A lease agreement often provides a date by which the store shall be open to the public. However, please note that the obligation to trade is also triggered by the law regarding trading licenses, according to which the licenses can be withdrawn by the competent municipality if the store does not trade for a given period of time.

c. Restrictions on Competitors

Tenants in both high-street stores and shopping centers/outlets can very rarely place restrictions on competitors.

d. Operating Hours

Operating hours are regulated by municipality law. Therefore, lease agreements for high-street locations do not normally refer to opening hours.

Lease of business agreements for stores in shopping centers or outlet do normally regulate opening hours.

e. Staffing and Stocking

Lease agreements for high-street locations do not normally refer to staffing and stocking.

Lease of business agreements for stores in shopping centers or outlets may regulate staffing and stocking.

5. Typical Rent Structures

The parties are free to agree on the rent without any statutory limitations. However, the rent cannot be increased/varied during the duration of the lease.

Therefore, parties usually structure the rent increase after the first year, there having been a rent reduction for the first year, justified by the costs faced by the tenant for renovation of the store.

Rent is normally indexed annually. Such indexation shall be linked to the Cost of Living Adjustment Index published by the Italian National Institute of Statistics.

In contrast, in the case of a lease of business, the rent is often structured as a fixed part, plus a part linked to the turnover.

6. Incentives and Key Money

The Italian Supreme Court has excluded the legitimacy of the so-called "key money" paid by the tenant-to-be to the landlord. However, it is not uncommon that a sort of "key money" be paid in the form of an increased rent.

The Supreme Court has admitted the legitimacy of money paid by the tenant-to-be to the current tenant, provided that the landlord is not involved in such a transaction and does not receive an economic advantage from it.

In the event of retail activity (as such activity involves direct contact with the general public), at the expiration of the lease (and save in the event the lease has been terminated by the tenant), the landlord must pay an indemnity to the tenant that is equal to 18 to 36 monthly rent installments, as a compensation for the loss of goodwill incurred as a result of the transfer of the tenant's going concern to a new location. In the event the retail spaces are used within one year for a commercial activity equal to the one carried out by the exiting tenant, the latter has the right to receive an additional indemnification equal to 1.5 years of rent.

In a lease of business agreement, such indemnity is not due.

Because of the loss of goodwill indemnity payable by the landlord to the tenant at the end of the lease, it is not uncommon that a trilateral agreement is reached among the landlord, the exiting tenant and the new tenant, according to which the exiting tenant agrees to withdraw from the lease (before its expiration) in exchange for key money paid by the new tenant in an amount equal to, or higher than, the loss of goodwill indemnity the landlord should have paid to the exiting tenant in the case of expiration (without renewal) of the lease.

7. Lease Term and Duration

a. Duration/renewal

The minimum duration of a lease is six years, while the maximum is 30 years.

Renewal for an additional six years is automatic unless either party gives a 12-month written notice of termination to the other. However, the landlord may terminate the lease after the first six-year term, only if he or she intends to use the premises for himself or herself to conduct a commercial activity or intends to demolish or restructure them. The landlord may also, and usually does, waive his or her right to refuse the request for first renewal.

b. Tenant's Termination Rights

The parties can include in the lease the tenant's right to terminate the lease at will, with at least six months written notice to the landlord.

A tenant has the statutory right to terminate the lease at any time, for a "serious reason", with at least six months written notice to the landlord. A "serious reason" is an event defined by case law as being unforeseeable, not dependent on the tenant's will, and that has materialized at a time subsequent to the entering of the lease by the parties.

In a lease of business agreement, the parties can freely agree on the duration of the lease. A termination right would also have to be specifically agreed upon.

8. Assignment, Transfer and Subletting

a. Sublease/assignment

Unless otherwise agreed between the parties, a tenant cannot sublease or assign the contract without the landlord's consent (except within the context of a transfer or lease of a going concern, in which case it is sufficient to inform the landlord by registered letter).

b. Pre-emption Rights

At the end of the second term, and thereafter in the event of additional renewals, the tenant is granted a pre-emption right if the landlord intends to continue leasing the premises. The tenant may, however, waive such a right in the lease agreement.

Furthermore, and unless the tenant has specifically waived such a right in the agreement, the tenant is granted a pre-emption right in the event of sale of the leased premises.

In a lease of business agreement, any pre-emption right would have to be specifically agreed.

9. Permitted Use Issues

A permitted use clause is very common, the breach of which normally triggers termination of the agreement.

The tenant should try to obtain a provision as broad as possible (e.g., retail sale of non-food products). However, landlords tend to prefer very specific provisions, also indicating the brand under which trade is permitted, so as to limit as much as possible the possibility of the tenant assigning the premises to third parties through transfers or leases of going concerns (which include the leased spaces).

Please note that the use of the space might also have an impact on the trading license and, in any case, the tenant shall comply with the provisions of said trading license.

10. Key Landlord Operating Requirement

The main obligations on landlords are to: (i) deliver the premises in a good state of repair; (ii) maintain them in conditions that allow the agreed use of them; and (iii) guarantee the peaceful enjoyment of the premises to the tenant during the lease.

Under the default rule of the Italian Civil Code, the tenant is responsible only for minor repair and maintenance work to the interior of the premises, while the landlord is responsible for the ordinary and extraordinary repair works. The parties are free to agree on how to allocate the expenses. Most commonly, the parties agree that the tenant bears the ordinary expenses of repair, and the landlord bears the extraordinary expenses, although landlords often try also to allocate the extraordinary expenses to the tenant, at least partially.

In a lease of business agreement under the default rule of the Italian Civil Code, the lessee is responsible for ordinary/standard maintenance and repairs, and the lessor is responsible for substantial maintenance and repair interventions. Parties can freely agree otherwise.

11. Security under Retail Leases

The tenant is normally required to pay a security deposit (in the form of a cash deposit or a bank guarantee). Cash deposits cannot exceed the aggregate of three months rent, whereas such limitation does not require a bank guarantee. Corporate guarantees are normally not accepted by landlords.

12. Fit-out Contracting and Consultancy Engagement

a. What is Available and what is the Condition of Space at Handover?

This is totally up to the parties to agree as they wish. Very often, the premises are delivered at row (*al grezzo*), so as to allow the tenant to personalize the store with its fit-out works.

b. Planning and Space Issues

In most cases, works to be carried out within the premises need to be approved by local authorities.

c. Landlord Consent Issues

Most commonly, the agreement provides that any change to the current status of the store may only be made with the prior approval of the landlord. It is very common to agree and attach to the lease agreement the first fit-out that the tenant wants and have it pre-approved by the landlord. Any subsequent change to it involving walls, the floor or another part of the premises is to be pre-approved by the landlord, unless otherwise agreed by the parties. However, landlords are normally not keen on accepting modifications to the premises without their prior approval.

The landlord has the right to require the tenant to deliver the premises back to it at the end of the lease in the same condition as they were in at handover. It would be in the interests of the tenant to negotiate that any change to the premises made by it with the approval of the landlord shall not have to be removed by the tenant at the end of the lease.

13. Brand Protection in Retail Leases

This is an issue arising only in leases within shopping centers or outlets where landlords require the right to use the tenant's logo for promotion/marketing purposes. It is advisable, and usually accepted by the landlord, to negotiate that any use by the landlord of the tenant's logo shall be pre-approved by the tenant.

Japan

1. Types of Leases

There are generally two types of leases in Japan. One is the ordinary lease, with statutory right of renewal except in certain instances, while the second is the fixed-term lease, with no right of renewal.

2. Lease Terms

There is no maximum term for leases, but ordinary commercial leases are often for two years, and fixed-term commercial leases are usually for five to 10 years. Sometimes, fixed-term commercial leases provide for a fixed term such as five years, coupled with a provision where the landlord agrees to discuss, in good faith, a new lease for the same duration if requested by the tenant within the specified period.

3. Lease Documentation Process

The lease documentation process usually starts with the letter of intent (heads of terms) and then the actual lease documentation is negotiated. The tenant then submits to the landlord a rental application, together with the executed lease agreement, for the landlord to approve and then to countersign the lease agreement. The security deposit, key money if applicable, and the first month's rent are usually required to be paid to the landlord when the tenant submits the rental application.

Mexico

1. What Laws Regulate Retail Leasing?

Retail lease agreements are regulated, like all other real estate leases, by the Civil Code for each of the respective states of Mexico and the Federal District, all of which are practically the same as they relate to retail leases.

There are no nationality restrictions on holding a lease, and there is no distinction between Mexican and foreign nationals in the process of securing retail space; however, tax implications may vary.

2. Use of Letters of Intent

Letters of intent are commonly used in Mexico. They are usually negotiated by the parties and their real estate agents, and lawyer involvement is low, though advisable if possible. They are usually non-binding, other than confidentiality and exclusivity provisions, if specifically stated. Letters of intent include the basic economic and commercial terms (premises, rent, rent-free periods, security, indexation, commencement date, term, break options, insurance, property tax, maintenance and marketing budgets, etc.). They vary in the level of detail included. The more detail that can be included (with lawyer involvement) the better, as, while they are generally non-binding, it can become more difficult to negotiate key issues at a later stage if they have not been agreed on in the letters of intent. Any brand-specific requirements should be flagged at this stage.

3. What are the Key Specific Retail Lease Issues?

a. Rent and other Lease Payments

Depending on the location, rent can be triple net rent, which includes maintenance, insurance and property tax, where for others, it can exclude property tax.

It is common to have a basic minimum rent with a percentage of gross sales where the basic rent is credited. Basic rent is usually then adjusted in line with the Consumer Price Index on a yearly basis. Rents are typically in Mexican pesos, but U.S.-dollar-denominated rents are not uncommon; in such cases, the Consumer Price Index used for adjustments is typically a U.S. index.

Five-yearly, upward-only rent reviews are the most common ones.

All expenses and management costs (including insurance, marketing and administrative costs) are usually covered by the tenant under a service charge.

b. Term

There are no maximum or minimum terms by law. Standard retail leases tend to be between five and 10 years.

The Civil Codes typically grant a tenant the right to call for a one-year renewal at the end of the original term of years, unless the landlord objects to such a renewal and demonstrates that he or she intends to use the premises; these provisions may be contractually waived and are typically waived by tenants.

A break clause can be negotiated for either party, but this is less common in retail leases.

c. Incentives and Key Money

Initial rent-free periods and fit-out contributions are standard tenant's incentives.

Key money (also known locally as a "*guante*" or glove) is common in the retail and luxury sector, for flagship store locations, such as Avenida Masaryk and downtown Mexico City, as well as high-traffic retail shopping centers. This varies, depending on the cities and demand for retail space.

d. Flexibility in Leases

Assignment and (less frequently) subletting are usually permitted only with the prior written consent of the landlord.

There is rarely any change to control provisions, but there are often provisions stating that only the tenant's brand may operate in the premises under the agreed brand names.

e. Trading

Leases for retail premises usually include “keep open covenants” (i.e., an obligation to trade). This is very common in shopping centers where turnover provisions apply, but is also the case for prime locations.

Restrictions on competitors and exclusivity provisions need to be negotiated on a case-by-case basis and agreed on in the lease.

Opening hours are often set out in leases, particularly in shopping center leases, and may also be governed by local municipality laws.

f. Decoration

It is not uncommon to find provisions that internal (and if relevant) external redecoration must be carried out by the tenant every five years.

g. Yielding Up at End of Term

The premises usually have to be handed back in a full state of repair, with all the tenant’s fixtures and fittings removed.

h. Fit-out

The fit-out is typically done by the tenant.

At handover, the premises are usually delivered in shell and core.

Fit-out works often require planning permission from the local council, prior to works commencing.

Typically, the design, fit-out and signage are subject to the landlord’s approval, which must not be unreasonably withheld.

i. Alcohol Products

Luxury brands may wish to serve alcohol (such as champagne) to clients. If the store is selling alcohol, a premises license is needed, as well as an appointed supervisor. An application to the local municipality will need to be made and the cost is typically set by local municipal governments.

If the retail store is giving away alcohol, it would not need to apply for a license, provided that a customer is not under an obligation to purchase something in order to get a free drink.

If soft drinks are sold, these are technically classified as food, so, depending on the municipality, the store would need to register with the municipality as a food business.

4. What Taxes affect Retail Leasing?

There are no special taxes for retail leases; instead, the following taxes are applicable (as under other real estate leases):

Value-added tax (VAT), which is currently at 16 percent, is applicable to rental payments under a retail lease agreement. Key money is also subject to VAT.

5. Registration

Leases of over six years need to be registered with the Public Registry of Property. The lease has to be ratified in the presence of a notary public and registration fees apply. Rates vary from jurisdiction to jurisdiction.

6. Security

A one- to two-month deposit is typically required. In addition, it is usual for a landlord to require some form of security, such as related entity or personal guarantee, or a surety bond.

Russia

1. What Laws Regulate Retail Leasing?

Retail lease agreements are regulated, like all other real estate leases, by the Russian Civil Code and the federal laws “On State Registration of Rights to Immovable Property and Transactions Therewith” and “On State Cadaster of Immovable Property”. Statutory norms stated in the Russian Civil Code and said federal laws are general and applicable to all kind of leases, including retail leases.

Certain specific norms that should be taken into account when negotiating retail leases are stated in some federal laws (as described below) and other normative Acts that regulate trade of goods such as alcohol and tobacco products. In this section, alcohol products means alimental products produced with or without the use of ethanol and containing more than 1.5 percent ethyl.

Russian law regulates the sale of goods, including luxury and fashion goods, but such regulations refer to sale/trade itself and not to the leasing of the premises for sale of the goods.

2. What are the Models for Multijurisdictional Rollouts?

With regard to retail leases, Russian law does not distinguish between Russian and foreign participants in the market, and the same statutory norms are applicable to both Russian legal entities and individuals, as well as to foreign legal entities and individuals.

Retail lease agreements can be structured like any other lease agreement and include the same models, i.e.: a preliminary lease agreement for preleasing in a building under construction; a short-term lease agreement (STL), which is a lease agreement made for a term of less than one year (less than 365 days); and a long-term lease agreement (LTL), a lease agreement made for a term of one year (365 days or more) or longer.

STLs do not require state registration and are effective from the moment of signing by the parties. LTLs require state registration and become valid and effective only from the moment they are state registered.

3. What are the Key Specific Retail Lease Issues?

There are certain statutory norms setting out the requirements for premises in which goods may be sold.

a. Alcohol Products

The federal law “On State Regulation of Production and Turnover of Ethyl, Alcohol and Alcohol Containing Products and on Restrictions to Consume (Drink) Alcohol Products” (the Alcohol Regulation Law) sets out requirements for premises intended for retail sale of alcohol products (such as wine or spirits).

b. Leased Premises Located in Urban Areas

Leased premises located in urban areas: (i) must be located in a fix-site (immovable) building; (ii) must be leased for a term stated in the lease agreement, but not less than one year, i.e., under an LTL; and (iii) the area of the retail or warehouse premises may not be less than 50 square meters.

c. Leased Premises Located in Rural Areas

For leased premises located in rural areas, (i)-(ii) above are applicable. However, the minimum area for shops and warehouses should not be less than 25 square meters.

In addition, the federal executive body of the Russian Federation government may develop special requirements for fixed-site (immovable) buildings in which shops and warehouses for alcohol products can be located.

The Alcohol Regulation Law lists places where retail sale of alcohol products is prohibited. In particular, retail sale of alcohol products is prohibited in educational, medical, sports and military establishments and on their adjacent territories, as well as in public places such as railway stations, bus stations and airports.

d. Tobacco Products

The Federal Law “On Health Protection of Citizens from Impact of Tobacco Smoking and Consequences of Tobacco Use” (the Anti-Tobacco Law) lists places where sale of tobacco products is prohibited (premises and territories of education, medicine, culture, sports establishments, airports, railway stations, hotels and others). The Anti-Tobacco Law also prohibits the retail sale of tobacco products on premises located within 100 meters of an educational establishment.

Tobacco products may be sold in a shop, which means a building or its portion: (i) which is specifically equipped for sale and provision of services to buyers; (ii) which includes retail, auxiliary and administrative premises; and (iii) which includes premises to accept, store and sell tobacco products.

If a retailer sells alcohol and/or tobacco products prior to leasing premises, it should carefully check whether the premises to be leased and the building in which the premises are located meet the requirements of the Alcohol Regulation Law and the Anti-Tobacco Law.

4. What is the Regional Jurisdictional Breakdown?

Authorized governmental authorities of the regions of the Russian Federation have the right to place additional limitations of time, terms and places of alcohol trade, including outright prohibition of the alcohol trade. However, regional authorities mostly apply federal statutory requirements.

5. What is the Retail Lease Legislation Relating to Customs?

Russian customs law provides for certain requirements for the sale of imported goods that a retailer should observe. However, there are no specific customs requirements for retail leases. The landlord, however, may require under a retail lease an agreement that the tenant observes statutory norms for trading imported goods. This would be a contractual agreement of the parties.

6. What are the Local Taxes for Retail Leasing?

There are no special taxes for retail leases and the following taxes are applicable (as under other real estate leases): VAT, which is currently at 18 percent, is applicable to rental payments under a retail lease agreement. A tenant normally covers expenses of the landlord for payment of the corporate property tax. The maximum corporate property tax rate is 2 percent of the cadastral value of the building, which may be reduced by the regional laws.

7. Key Licensing and Retail Presence Approval Issues, including Governmental Licensing Requirements for Trading

Under the Alcohol Regulation Law, licensing of the retail sale of alcohol products is required. Licenses for the retail sale of alcohol products are issued by the governmental executive bodies of the regions of the Russian Federation. The regions of the Russian Federation may delegate their powers to issue licenses to local authorities. A license issued by one region of the Russian Federation may be effective in the territory of another region of the Russian Federation, provided that such regions of the Russian Federation have a relevant agreement between them.

The Alcohol Regulation Law lists documents that should be provided to obtain a license, including a lease agreement and documents confirming that the premises and building meet the requirements of the Alcohol Regulation Law (as described above).

The authorized governmental authority should issue a license (or give a motivated refusal) within 30 days after receipt of an applicant's documents. The licenses are issued for a term requested by an applicant. The maximum term of a license is five years. The license may be extended for a term not exceeding five years.

The licenses (issued, suspended or annulled) are recorded with the state register of licenses, which is maintained by the authorized executive body appointed by the Russian government.

8. Are Tenant Representatives Appointed?

Lease agreements, including retail leases, include addresses and contact persons of the landlord and the tenant. Russian law does not prohibit the parties from appointing representatives for settlement of everyday issues. This should be a contractual agreement of the parties under a lease.

The United States

1. Lease Documentation Process

In the U.S., retail lease documentation is highly standardized, with most major shopping center owners and developers using their own standardized form (with any necessary local law changes added) in their respective states. The documentation is quite extensive, and negotiating a new lease can take anywhere from a week or two to several months. Some regional operators and standalone locations will not have documentation that is as streamlined as that found in larger regional malls. Those transactions often involve more extensive negotiation. In the U.S., retail leases used by major owners and developers will always be in the English language.

There is generally no requirement in the U.S. that a lease be recorded. In fact, it is very rare to record an entire lease, as most landlords and tenants, for confidentiality reasons, do not want the terms of their transaction to be a matter of public record. It is, however, fairly common and, in fact, desirable for significant leases to have a memorandum of lease recorded, in order to protect the tenant from a termination of its lease in the event of a foreclosure by a subsequent mortgage. This is usually a one- or two-page document that describes the basic terms of the lease, such as the parties, term of the lease, extension and expansion rights. The format of these memorandums may vary from state to state, given the different local recording requirements, and will require that they be acknowledged before a notary public.

2. Key Money

Key money is not a concept that is commonly found in the U.S.

3. Transfers, Assignments and Subletting

In the U.S., almost all retail leases have restrictions on transfers that are broadly written to include not only direct assignments and sublettings, but also indirect transfers, such as stock and equity transfers. Restrictions usually extend, as well, to encumbering the leasehold estate through financing transactions and to licensing the space. While some leases require the landlord to be reasonable in granting or withholding consent, it not uncommon to see a sole discretion standard imposed.

Lease documentation also usually imposes conditions that the tenant must meet in requesting the landlord’s consent, such as providing copies of the transfer documentation, and background and financial information about the transferee.

Typical carve-outs to the consent requirement are affiliate transactions, mergers and consolidations, and transactions involving the sale of the tenant’s business, as opposed to a single store transfer. Such a carve-out often requires that a minimum number of stores be transferred.

If the landlord consents to an assignment or subletting, there is usually a requirement that any profits the tenant earns on the assignment or subletting be shared with the landlord, usually on a 50-50 basis.

4. Permitted Use

Permitted use clauses are standard provisions in U.S. retail leases. They will typically specify in a generic way the types of goods that may be sold and often reference the tenant's brand. If the location is an outlet location, the clause will often specify the price point that goods must be sold at.

In addition, it is typical for the clause to allow for a certain percentage of the space to be used for ancillary purposes, such as storage and back-office use.

Finally, there may be restrictions prohibiting sale of products that may be in competition with other brands or tenants in the specific location.

5. Operating Requirements

In the U.S., it is not uncommon for larger regional malls to have a marketing and promotional program that may be maintained by the landlord or by a marketing association comprising the various tenants in the mall. Leases will typically provide that the tenant contribute to a marketing or promotional fund on a fixed-cost basis with an annual adjustment. In addition, some leases will obligate the tenant to do its own marketing with specific mention of the shopping center. Larger brands will usually be able to satisfy this requirement through their national marketing programs.

United Arab Emirates – Abu Dhabi

1. Legislation – What Laws Regulate Retail Leasing?

Law number 20 of 2006 Concerning the Rent of Places and Regulating the Rental Relation between Lessors and Tenants in the Emirate of Abu Dhabi is the law that governs retail leasing in Abu Dhabi, as amended by Law number 4 of 2010.

The legislation is relatively modest and the main provisions are as follows.

a. Alienation

The tenant is not permitted to assign the lease, or sublet the whole or part of the retail unit, without the written consent of the landlord.

b. Holdover

If the retail tenant remains in occupation of the retail unit at the expiration of the term without any objection from the landlord, the lease is deemed to have renewed on the same terms and conditions for a similar term.

c. Termination

The landlord has a right to evict the tenant from the retail unit if the tenant fails to pay the rent as it falls due; assigns or sublets the retail unit without the landlord's consent; uses the retail unit contrary to the permitted use; permits the retail unit to be used in a way that is detrimental to health, or contrary to public orders or manners; or if the landlord demolishes the retail unit for rebuilding, elevation, additions or alteration (subject to a number of conditions).

2. Registration

All leases that are entered into in Abu Dhabi must be registered with the Abu Dhabi Municipality. There are two separate systems, Tawtheeq and Tamleeq.

a. Tawtheeq

Leases with a term of four years or less are registered under the Tawtheeq system. Termination, renewal and surrender are also carried out under the Tawtheeq system.

During the Tawtheeq registration process, a number of details are required, including (but not limited to) the term of the lease, the rent, the contact details of the lessee, the tenant's trade license details and the details of the individual representing the tenant.

Where the parties have negotiated additional clauses, an attachment of special terms and conditions can be submitted, and these are reviewed by the Legal Affairs Department of the Abu Dhabi Municipality. The Legal Affairs Department has the discretion to reject the terms and conditions if it thinks that they are inconsistent with the general terms of the lease, the legislation and other applicable guidelines. The landlord is responsible for the cost of registration and is not allowed to pass on the cost on to the tenant.

b. Tamleeq

A lease with a term of four years or more is registered under the Tamleeq system. The Tamleeq registration process and requirements are yet to be confirmed by the Abu Dhabi Municipality. A fee of 1 percent of the rent during the first year is payable for the registration. The parties can agree who is responsible for the registration cost. Landlords often seek to pass this cost on to the tenant.

United Arab Emirates – Dubai

1. Legislation – What Laws Regulate Retail Leasing?

Law number 26 of 2007 Regulating the Relationship between Landlords and Tenants in the Emirate of Dubai, as amended by Law number 33 of 2008, applies to retail leases in Dubai.

In addition, Decree number 2 of 2011 Regarding Rentals in the Emirate of Dubai regulates any rent increases. Administrative Resolution number 134 of 2013 relates to the registration of leases in Dubai.

The main provisions of the legislation are as follows.

a. Term

The period at which the lease commences and expires must be specified in the lease. The legislation does not provide a minimum or maximum term, other than that a lease of more than

10 years is considered a real property right at law and, therefore, foreign ownership restrictions apply to such interest.

b. Holdover

If the tenant remains in occupation of the retail unit at the expiration of the term without any objection from the landlord, the lease is deemed to have renewed on the same terms and conditions for one year or the term of the original lease (whichever is less).

c. Renewal Terms

A tenant is able to renew a lease, except in limited circumstances. Any such renewal will be on the same terms and conditions (including rent) unless notice is served, by either party on the other, as to any changes at least 90 days prior to the expiry date, and those changes are agreed. Failing agreement, the matter may be referred to the relevant tribunal in Dubai.

At law, the landlord may only evict the tenant upon expiry of the tenancy contract in the following cases:

i. if the landlord wishes to demolish the property for reconstruction or to add new constructions that prevent the tenant from benefiting from the leased property;
ii. if the landlord of the property wishes to sell the leased property;
iii. if the property requires renovation or comprehensive maintenance that cannot be executed while the tenant is occupying the property; and/or
iv. if the landlord wishes to recover the property for use by him or her personally or by his or her next of kin.

The landlord must notify the tenant of the reasons for eviction at least 12 months prior to the determined date of eviction.

d. Maintenance

The landlord is responsible for the maintenance of the property, and must rectify any defects or faults that affect the tenant's intended benefit of the property.

e. Approvals

The landlord is obliged to provide the tenant with all approvals required by the authorities to carry out decoration or other works that require the authorities' approval.

f. Alterations

The tenant requires the landlord's permission for carrying out any changes, renovation or maintenance works once it has obtained the relevant approvals from the competent authorities.

g. Alienation

The tenant must not assign the lease or sublease the retail unit without the prior written consent of the landlord.

h. Eviction During the Term of the Lease

The landlord has a right to evict the tenant during the term of the lease in a limited number of circumstances. These include if the tenant has not paid the rent within 30 days of the landlord notifying it of the need for payment or if the tenant subleases the retail unit without the landlord's written consent.

i. Rental Increases

Any rental increases made by the landlord must be in accordance with the rental index, which is prescribed by the Real Estate Regulatory Authority (RERA). The rental index is a tool that determines the rents of properties across Dubai and provides the percentage of the permitted maximum rental increase.

2. Registration

All leases that are entered into in Dubai must be registered. A lease with a term of less than 10 years is registerable on the Ejari register, which is managed by RERA. A lease with a term of 10 years or more (up to 99 years) is registerable with the Dubai Land Department (DLD) on the Real Property Register.

A fee equivalent to the value of 4 percent of the rent contract is payable for the registration of the long-term lease with DLD. A nominal fee of approximately AED195 is payable for the registration of a short-term lease on the Ejari register.

United Arab Emirates – Common Issues in Abu Dhabi and Dubai

1. Use of Letter of Intent

With lease negotiations in the region often being protracted, it can be costly and time consuming if the main provisions are not agreed at the outset. It is, therefore, better if the parties agree as many provisions as possible at the start. Letters of intent are commonly used in Dubai, and are often negotiated by the parties or commercial real estate agents. It is becoming increasingly common for lawyers to be instructed on a letter of intent for a larger shopping mall, where the terms are often more complex.

2. Agreement for Lease and Lease

With a number of malls and developments under construction in the United Arab Emirates, it is very common for an agreement for lease to be entered into by the parties, with a schedule of the main lease attached.

The agreement for lease provides that a number of conditions are to be fulfilled before the lease will take effect. Such conditions are normally the landlord carrying out works and providing vacant possession. The tenant often has a right to enter the premises and carry out any relevant tenant works. The parties normally agree a date by which the conditions must be satisfied.

The lease is usually signed by both parties and held in escrow until completion, when it is dated and becomes legally binding. This can cause issues for tenants new to the market, as the authorities require a copy of a signed lease before issuing a trade license. In turn, this can delay the tenant in obtaining utilities for the premises (where they are not provided by the landlord) and setting up bank accounts for the company.

Due to this, there has been a recent change to the agreements being entered into in a number of the larger developments, with the agreement for lease and the lease being combined in one document.

3. Market Trends Relevant to Retail Leases

a. Rent

In shopping centers, it is usual for turnover rents to be payable, in addition to the basic rent. A service charge is normally payable by the tenant to the landlord, which will cover management costs, insurance, marketing and administrative costs.

b. Term

Retail leases in shopping centers in the United Arab Emirates normally have a term of approximately five to seven years. Smaller developments often have shorter terms. Tenant renewal rights are common, subject to the rent being reviewed.

c. Incentives

Rent-free periods are common, while fit-out contributions by the landlord are rare.

d. Flexibility

Market practice dictates that alienation is permitted only with the prior written consent of the landlord. In more sophisticated shopping center leases, change of control provisions are common.

e. Trading

“Keep-open provisions” are common in shopping center leases, and there will often be restrictions on products or services, to ensure that they comply with Islamic law and customs. The sale of alcohol and pork is only permitted with a special license that is granted by the authorities (at their sole discretion). There are a number of conditions in obtaining such a license: e.g., the products must not be sold to a Muslim and the retail unit must be linked to a hotel. It is common for parties to negotiate restrictions on competitors, as well as exclusivity provisions.

f. Decoration

Internal decoration obligations on the tenant are common.

g. Yield Up

The tenant is usually obliged to return the retail unit to the landlord in the condition that it was received at the commencement of the term. The tenant is normally responsible for the cost of yielding up.

h. Fit-out

Often, the tenant is responsible for obtaining the relevant licenses, consents and approvals from the authorities for undertaking the fit-out works. The landlord is commonly required to "assist" the tenant in obtaining such licenses and/or approvals.

Chapter 10: Resolving Disputes: Litigation, Arbitration and Mediation[1]

Part One

I. Introduction

All businesses, whatever their size, have some litigation exposure. It is an everyday hazard for many industries, including brand owners and manufacturers, and the best-run companies in these sectors recognize this by adopting appropriate risk-management systems to avoid being involved in disputes that could spiral out of control.

The pressure to approach dispute management very carefully, however, is not simply a matter of considering cost implications but also the risk to a company's reputation of entering into long, drawn-out litigation. Negative press in the home jurisdiction is bad enough, but for a multinational company, wishing to be perceived in the various countries in which it operates as a local, rather than global, organization, a dispute in a country other than its home jurisdiction can have extra adverse consequences. (We will examine how to manage this further in the "Crisis Management" section below.)

The key to effective dispute management is to keep an eye on the future and ask questions such as: What could go wrong? Where? What types of claims are likely to arise? How and where could those disputes be managed? These questions should be addressed at a number of stages in the business cycle, but are particularly important when drafting commercial contracts or planning strategy.

The types of claims that could arise in this industry are predominantly intellectual-property-related, but potentially also include product-liability claims, or could arise from false or negative advertising campaigns, particularly with the rise of social media[2]. In addition, contractual disputes could arise: e.g., between brand owners and manufacturers or suppliers.

In this chapter, we will look first at some of the key issues faced by companies when considering dispute resolution from a global perspective and what measures they can take to avoid, or effectively manage, a dispute, as well as providing a brief overview of arbitration, mediation and other forms of alternative dispute resolution (ADR). We will then move on to consider specific issues relevant to key territories in this industry, picking out both the procedural requirements when commencing a claim or entering into arbitration or ADR, as well as identifying key elements of litigation, arbitration and ADR specific to those territories. In addition, we will

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[1] Joanna Ludlam of the London office and Grant Hanessian of the New York office are the principal authors and editors of this chapter. They gratefully acknowledge reliance on the Chicago office's Michael L. Morkin's chapter "Dispute Resolution Clauses II: How to Chose Arbitration" in International Arbitration Checklists (Hanessian & Newman, eds, Juris Publications, 2d ed. 2009). The country specific sections were prepared by Mark Chapple and Amana Turnill, Sydney; Marcio S. Polto, Sao Paulo; Javier Navarro-Velasco, Monterrey; Haig Oghigian and Kengo Nishigaki, Tokyo; Ying Wu, Beijing; Angela Ang, Susan Kendall, Gary Seib, Anthony Poon and Cynthia Tang, Hong Kong; Jean-Dominique Touraille and Eric Borysewicz, Paris; Joerg Risse and Juergen Schramke, Frankfurt; Gianfranco Di Garbo, Milan; Edward Bekeschenko and Vladimir Khvalei, Moscow; Maxim Kalinin, St. Petersburg; and Benjamin Roe, London.

[2] See Chapters 1 and 4 for related discussion.

highlight any recent cases, where applicable, that draw out some of the issues discussed and provide useful lessons.

II. Dispute Resolution

A. Cost Implications of Dispute Resolution

Companies should consider the cost implications of entering into expensive litigation, and in some jurisdictions there have been reforms that impose a necessity for companies to seriously consider other forms of dispute resolution, such as arbitration or mediation (as discussed further below). Even if a dispute does progress to litigation, the courts in some countries insist on parties adopting more cost-effective measures during the litigation process, such as the increased use of electronic trials and e-disclosure, and encouraging parties throughout the process to enter into settlement negotiations. We will look further at these specific elements of litigation (with reference to certain key territories) later on in the chapter.

B. Effective Drafting

So, what can companies do to address dispute resolution when drafting a contract – in particular, where there is potential for a dispute involving different jurisdictions? This is especially pertinent to the fashion and luxury industry, as businesses often contract out the manufacturing or supply process to companies overseas. Some mechanism for dispute resolution should be incorporated as a matter of course into any contract, and a comprehensive dispute resolution clause dealing with jurisdiction, governing law and procedure should also be included.

C. Jurisdiction

If your company could be exposed to a cross-border dispute, the choice of jurisdiction in a contract is an important factor. Jurisdiction refers to the competence of a court to resolve a dispute. Some points to consider when deciding whether to include a jurisdiction clause in a contract are that (i): it enables the parties to agree, at the outset of their contractual relationship, which country's courts are to have jurisdiction to hear disputes arising from the contract; (ii) it can allow the parties to avoid the jurisdiction of certain courts that may be undesirable; (iii) it can avoid the considerable time and costs involved in disputes over which courts have jurisdiction; and (iv) it can increase the possibility of enforcement of the court's judgment if the parties choose a respected jurisdiction.

If the contract has an international aspect, failure to incorporate effective jurisdiction clauses can have significant disadvantages in the event of subsequent cross-border disputes, such as: (i) the claim being brought in a foreign court with unfamiliar law and procedures; (ii) some jurisdictions insisting on the case being held in the local language, which would involve a company having to enlist interpreters, thereby increasing the cost of the litigation (China, where court cases are exclusively heard in Mandarin, is one example of this); (iii) there may be restrictions on the choice of representation, and potentially unduly restrictive or excessive awards of damages and costs; and (iv) the possibility of a biased tribunal.

Some of the issues that should be considered when deciding which court to choose are:

- practicality and convenience – the availability and costs of legal representation and the location of the parties and witnesses;
- quality and language of the courts;
- procedural issues – disclosure and recovery of costs;
- speed and cost of the litigation process; and
- the need for effective enforcement of any judgment or award.

Choice of governing law is also a matter of strategic importance in negotiations between parties from different jurisdictions, as each side will normally want the law of its home jurisdiction to govern, so that disputes will be resolved under a system with which they are familiar.

As a matter of good management, carrying out a regular audit of the company's contracts can ensure a certain degree of consistency. Many companies are regularly doing deals of a similar nature and conducting similar business in different locations. Looking at the range of contracts the company has, analyzing how and where disputes are likely to arise and how the company wants to deal with them, allows you to put in place dispute-resolution mechanisms that are suited to the individual corporate culture and give the company a greater degree of control and consistency of approach.

D. Other Issues to Consider in Cross-border Disputes

It is important when thinking about cross-border disputes to consider the recognition of foreign judgments. Judgments of a foreign court are not always automatically enforceable in the country where the defendant resides and there may be additional steps to take. Further detail is below, in the section "*Resolving Disputes in the Courts of Key Territories of the Luxury Brand and Fashion Industry*", which sets out the rules governing the enforcement of foreign judgments in each individual territory.

E. Crisis Management

Litigation is essentially an everyday event in the life of a business, rather than being a crisis as such; however, a high-profile dispute can attract intense public attention and media scrutiny. The media now engages in an almost forensic examination of the activities of businesses. Perhaps as a result of the demands of 24-hour news, journalists are becoming more inquisitive and pushing on issues they perhaps would have not pursued before. At the same time, newspapers are publishing more in-depth articles. In addition, with the rise of social media, bad news can rapidly travel to a worldwide audience, with huge implications for a brand. Within minutes of a crisis developing, the story can be tweeted, emailed or "go viral" on the internet.

Even if your company is eventually victorious in litigation, by that time it may be too late to safeguard your corporate reputation. Before the case is even judged in a court of law, your organization may be found innocent or guilty by the media. As a result, even if your organization wins the case, its brand may have already suffered significant injury.

Managed effectively, a crisis can be deployed as a trigger for necessary change, and can even enhance a brand's image and the organization's reputation. There are three essential components of effective reputation management when in a crisis. First, an organization should prepare and plan for a crisis in advance. Second, you should deploy your lawyers effectively and appropriately. Finally, seize the opportunity a crisis presents.

Your organization should seek to identify the likely sources of reputational risk and monitor them. That essentially means being aware of weaknesses in your business. This could include, e.g., compliance issues, legal disputes, anticipated poor financial results, planned redundancies, or weaknesses in your operating systems. Good crisis management is interlinked with business strategy and decision making.

All organizations should have in place an internal team to deal with any crisis. This team will be tasked with doing the initial tactical analysis of the issue, and planning how you intend to respond to it. If the systems and processes are already in place, these can be mobilized as quickly as possible to enable you to regain control.

Part of your planning and preparation could include drafting pre-prepared holding statements that contain the basic facts about an incident and letting people know that your organization is dealing with the situation. Your planned response should be tailored to the geographical location of a particular crisis. This includes being aware of cultural differences and considering how to adjust your approach accordingly. What might be effective in the UK could be construed very differently in Asia or the Middle East.

It is useful to involve lawyers in helping an organization fashion an appropriate and accurate response. Effective crisis-management lawyers will ensure statements to the media ring true with the organization's stated position, and think through what the potential liabilities may be. The other advantage is that they can act as an intermediary to deliver the message to the journalist, to avoid the risk of suddenly breaking a legal restriction or accidentally making an admission of liability. Giving away too much information cannot be easily fixed.

Thought should also be given to the availability in the public sphere of certain documents related to the litigation. Generally, a party who is not a party to the proceedings may obtain from the court records a copy of a statement of case and a judgment or order given or made in public. Depending on the nature of the case, an organization involved in litigation may wish to consider obtaining orders that certain documents are not made available for inspection. There are rules in certain jurisdictions that govern when documents deployed in litigation become a matter of public record. In the UK the starting point is that a party who obtains a document through the disclosure process may only use the document for the purpose of the legal proceedings in which it has been disclosed, save in certain circumstances. This may vary across territories but is worth noting.

A crisis may be unwanted, but it can operate as a trigger for necessary change and can even present your organization with an opportunity to enhance its brand through the way it deals with the particular issue it is facing. Make sure the story written about the crisis is your organization's story. A tardy response is ill-advised. It is important to recognize that you have a problem and be very honest about it. Effective crisis management must also include an apology. Saying sorry without damaging a company's position in litigation is often a painful duty for the company's executives, but the lawyer can ensure that the apology is safe, sincere, factually correct and delivered at the earliest possible moment. If any apology is pitched appropriately, and delivered well, it can sometimes bring the unexpected benefit of improving your organization's image, or at least ensuring that your crisis is viewed sympathetically.

F. Social Media

The pitfalls of litigating in the age of social media include how to deploy it effectively and meaningfully without falling foul of the law or otherwise damaging your case. In recent years there have been some spectacular instances of ordinary social media users unwittingly breaching court orders, committing a contempt of court or circulating libelous material while commenting on cases or circulating information using Facebook and Twitter.

While the general principle is that there is no prohibition on expressing an opinion in any public statement, careful regard ought to be had to the content of any proposed publication. Similarly with regard to witnesses, while there is nothing to prevent them from speaking publicly once the case is concluded, it is generally undesirable for individual witnesses to speak publicly about the case, as they may unwittingly undermine their own evidence and fragment a company's central message. It is best that all communications come from a company's designated internal team, to avoid conflicting communications and/or inadvertently releasing damaging or unhelpful material.

III. Alternative Dispute Resolution

A. Arbitration

There are many factors involved in the choice as to whether to opt for arbitration or litigation. One of the principal attractions of arbitration in the international context is that of neutrality. In determining what remedies will offer the best protection, it is important to be aware of the idiosyncrasies of particular countries. Remedies have to be tailored to the jurisdiction in which business is envisaged. Mexico, e.g., does not provide the kind of injunctive relief available in the U.S. Similarly, in some countries, intellectual property disputes cannot be resolved by arbitration. In negotiations on individual deals, it is good practice to discuss dispute resolution as early on as possible, and not leave it to the last minute, when the subject might not get the attention it deserves.

For years, arbitration clauses have been copied from contract to contract along with other boilerplate provisions, without significant attention to whether the clause is appropriate for the parties, the particular contract or the types of disputes most likely to arise. As contracting parties increasingly opt for arbitration as their dispute-resolution mechanism, more attention should be given to the arbitration clause.

Many contracting parties do not understand all the implications of an abbreviated arbitration clause; nor do they realize that they may contractually tailor most aspects of future arbitrations. The parties are always free to agree upon more specific procedures, even after the dispute arises or the arbitration begins, although it is, of course, often more difficult to agree on such terms after a dispute occurs than at the outset of a relationship.

There is no single arbitration clause that will fit the broad range of possible international commercial disputes. Thus, when drafting the arbitration clause, the parties should consider the nature of the transaction as they consider the options below. Some basic factors to contemplate include the nationality of the parties, the governing law of the transaction, the language of the contract, the place of performance, and the term of the relationship. Consideration should also be given to more strategic questions about the types of disputes most likely to arise. Who will be the likely claimant? Who will be holding the money or goods? Who will be holding the records or other evidence? What is the desired relief? Where are the parties' assets? The answers to these questions should guide those negotiating an arbitration clause to draft it in a way that is appropriate for the situation.

B. Scope of Arbitration Clauses

Under most national judicial systems, there are extremely limited grounds for overturning an arbitral award.[3] One of the few remaining defenses to enforcement is that the arbitral award goes beyond the scope of the arbitration clause. Most parties who enter into arbitration agreements intend for them to be as broad as possible. Such clauses usually provide for the arbitration of "any controversy or claim arising out of or relating to this contract . . . ." To avoid confusion, it may be appropriate to expressly include "the validity of this arbitration agreement or the entire agreement" within the scope of arbitrable disputes, though most arbitration rules and the widely recognized doctrine of *kompetenz-kompetenz* provide that an arbitral tribunal may determine questions of its own jurisdiction.[4]

Although most disputes have been deemed arbitrable in many jurisdictions, there are national legal systems that do not take such an expansive view regarding the arbitrability of certain disputes or rights. Non-arbitrability leads to non-enforceability of arbitral awards in those jurisdictions, although the prevailing party may still enforce the award against assets the foreign corporation may have in arbitration-friendly countries.

One particular area of concern in many countries is the arbitrability of intellectual property rights. Accordingly, if a party knows at the outset that future disputes are likely to involve intellectual property rights, it should determine whether such rights are arbitrable in the place of arbitration and the place of desired enforcement. If such rights are not arbitrable in either one of those venues, the parties should consider carving intellectual property disputes out of the arbitration clause. Jurisdictions that generally do not favour, or limit, the arbitration of intellectual property disputes include Brazil, Finland, France, India, Ireland, Israel, Italy, Japan, Korea, South Africa and Spain. Jurisdictions that generally permit arbitration of intellectual property disputes include the U.S., Belgium, Australia, England and Switzerland.

Some arbitration clauses attempt to bind one party to arbitration while reserving for the other party the option to seek redress in the courts. In certain jurisdictions, such clauses may be unenforceable for lack of mutuality. In international cases, however, such clauses are often used to good effect, particularly in banking transactions, where the lender may wish to have the option of obtaining an arbitral award, but also wishes to have the option of seeking summary judgment in court in a case of straightforward default (summary judgment not usually being available in arbitration).

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[3] *See* UNCITRAL Model Law, art. 34 (*see* Appendix 3); *see also* New York Convention, art. V (*see* Appendix 1).

[4] This is not necessarily the case in the U.S, however. See *First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 681 (1995).

C. Conditions Precedent to Arbitration (Negotiation, Mediation)

Parties who anticipate an ongoing relationship, even after a dispute arises, often require the exhaustion of a less adversarial process before resorting to arbitration. Typical examples include an opportunity to cure, or a "best efforts" provision requiring the parties or authorized executives to negotiate in good faith for a specific period of time (i.e., 30 days) before they are entitled to give notice of arbitration. Another alternative is to require mediation or conciliation prior to resorting to arbitration. If such a precondition is desired, it is advisable to place a reasonable time limit on the pre-arbitration steps. It is also advisable to reserve the right to seek interim relief at any time.

D. Place of Arbitration and Language

In a situation where the parties have relatively equal bargaining power, often the only mutually acceptable forum will be a neutral one. The location of the arbitration is significant, in that it generally implies a choice of applicable procedural law and determines the courts to which the parties will likely need to turn for ancillary relief. The law of the forum does not need to match the governing law of the contract itself, but it is often convenient for it to do so, since this will avoid the need for the appointment of lawyers experienced in two systems. An important consideration when selecting a foreign or unfamiliar venue is the local arbitration legislation (i.e., grounds to vacate, appeal or otherwise permit judicial intervention). In some countries, the right to appeal an arbitration award is quite broad. Moreover, in limited jurisdictions, the choice of arbitrators is restricted.

Of particular importance in international cases is the applicability of a convention or treaty providing for the recognition and enforcement of arbitration agreements and awards. If the country in which the arbitration takes place and the country where enforcement is sought are both parties to the New York Convention, enforcement should be relatively straightforward.[5] Many states (e.g., China) have ratified the New York Convention, subject to declarations that they will only apply it to the enforcement of awards made in another Convention state. Thus, in order to ensure that any award is enforceable in all Convention states, it is advisable to select a state that is a party to the Convention as the place of arbitration.

In contracts involving multilingual parties, the language of the arbitration proceedings should be decided in the initial contract. This language requirement may limit the pool of available arbitrators, lawyers and experts. Generally, it is advisable to provide that the arbitration be conducted in the language in which the contract was written. Such a provision can also deal with the selection and cost of an interpreter. The location of the arbitration can also impact the language, as certain countries require the arbitration to be conducted in their national languages.

Common venues for international arbitration include London, Paris, Geneva, New York, Stockholm, Zürich, Singapore and Hong Kong. Latin American parties often provide for arbitration in Mexico City, New York, Miami and Houston.

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[5] Other conventions may be useful in this regard. E.g., the United States and 15 Latin American countries are parties to the Inter-American Convention on International Commercial Arbitration (Panama Convention), which provides a similar reciprocal enforcement obligation as the New York Convention.

E. Institutional Rules or Ad Hoc Arbitration

The paramount issue involved in drafting an arbitration agreement is whether to use an institutional or an *ad hoc* arbitration clause. Institutional arbitration clauses invoke the administration of a formal organization such as the American Arbitration Association's International Centre for Dispute Resolution (AAA-ICDR). *Ad hoc* arbitrations are conducted in accordance with the rules defined in the contract and the procedural arbitration law of the place of arbitration. In an *ad hoc* arbitration, the arbitrators and parties will run the case without the administrative assistance of an institution or institutional rules. While this provides significant flexibility and saving of costs, it can result in applications to a national court for assistance where agreement cannot be reached on various aspects of the process. Such resort to the courts becomes necessary because *ad hoc* arbitration presents the opportunity for a recalcitrant defendant to obstruct the process, particularly before the arbitrators are appointed. For parties that anticipate being the defendant, this use of obstruction, like many other aspects of the arbitration clause, can be used as a weapon.

The United Nations Commission on International Trade Law (UNCITRAL) Rules may be selected by parties in an arbitration agreement without incurring the additional expense of an administrative body. There are some functions, however, where an outside body is required, such as appointing the tribunal in the absence of agreement between the parties. It is therefore essential, when providing for UNCITRAL arbitration, or *ad hoc* arbitration, to identify an "appointing authority". Failing this, an application will need to be made to the Permanent Court of Arbitration in The Hague, which will designate an appointing authority. In many UNCITRAL and *ad hoc* arbitrations, the parties designate an institution as the appointing authority.

Although such a provision may be prudent, the contracting parties are not required to name or use any particular arbitral administrative body. Most arbitral bodies have comprehensive, tested and oft-revised sets of procedural rules (i.e., those of the International Chamber of Commerce (ICC), AAA-ICDR, London Court of International Arbitration (LCIA), Singapore International Arbitration Centre (SIAC), Stockholm Chamber of Commerce (SCC), Japan Commercial Arbitration Association (JCAA) and Hong Kong International Arbitration Centre (HKIAC)). Cost is the primary disadvantage of institutional arbitration.

F. Number of Arbitrators and Selection Process

Most arbitrations are decided by a single arbitrator or a (more expensive) panel of three arbitrators. It is also possible to agree on a hybrid approach providing for a single arbitrator, except that in the event any party's claim exceeds a certain amount (exclusive of interest and lawyers' fees), a panel of three arbitrators shall determine the dispute. If the parties do not agree on the number of arbitrators, it will be determined by the procedural rules selected or by the law of the place of arbitration. Some rules give the institution discretion. The UNCITRAL Rules call for three arbitrators unless the parties agree otherwise. Conversely, the ICC, AAA-ICDR and LCIA Rules provide for disputes to be settled by a sole arbitrator unless the parties provide otherwise, or unless a panel of three arbitrators is deemed necessary.

Arbitrators can be selected by the parties, or by an arbitral institution. The typical "party-appointed" method, adopted by, e.g., the ICC and UNCITRAL Rules, allows each side to designate one arbitrator and the two selected arbitrators then appoint the third. Under the LCIA Rules, however, the institution will appoint all members of the tribunal unless the parties have expressly agreed to party appointment. The arbitration clause can also specify by name the individual(s) whom the parties want as their arbitrator. The potential unavailability of the named individual poses a risk, although the fact that a particular arbitrator or arbitration forum is not available will not necessarily affect enforcement of the arbitration clause.

When providing for party appointment of arbitrators, it is best to specify a time frame within which it must be accomplished. Some arbitration clauses specify that each party must designate an arbitrator no later than 30 days after arbitration is requested. Typically, if one party fails to name an arbitrator within the requisite time period, the institution or appointing authority can be requested to make the appointment. Parties who seek to establish an *ad hoc* method of appointment should provide a fallback procedure. For a relatively small fee, most administrative bodies will act as appointing authority without requiring the parties to invoke the entirety of their administrative services.

G. Discovery

If not addressed, discovery of documents and testimony, through depositions, is left to the arbitrators, who are greatly influenced by experience and nationality. For example, arbitrators who are retired U.S. judges may conduct arbitrations much like they ran their courtrooms, including a tolerance for broad discovery. Arbitrators with a civil law background typically abhor common law-style discovery and lean toward very limited, if any, discovery.

In recent years, the International Bar Association Rules on Taking Evidence in International Arbitrations (IBR Rules) have become widely accepted and are now often the default for arbitrators where the parties cannot agree on the scope of discovery in an arbitration. The IBA Rules attempt to find a balance between the civil and common law approaches to discovery. They provide detailed procedures for document requests that are broader than typical arbitration practices. However, most international arbitrations, as well as the IBA Rules, do not permit the taking of oral depositions as a part of discovery. Like nearly all aspects of arbitration, the parties are free to agree upon time limits for, or the scope of, discovery. The parties may agree upon these procedures in an arbitration clause or risk having such rules foisted upon them by an arbitrator. The options include no discovery; specified documents only; exchange of exhibits in advance of the hearing; or the right to subpoena or demand documents at or before the hearing. Similarly, the options with respect to witnesses include identity only, disclosure of the topic and/or substance of the witness's testimony (possibly by affidavit) or limited or full depositions.

H. Consolidation

If a dispute may involve more than two parties, it is important to provide for the inclusion of multiple parties. Most arbitral institutions take a relatively narrow approach to consolidation and joinder. Additionally, U.S. case law holds that the issue of whether to consolidate arbitration proceedings is a question for the arbitrators, not the courts.

Issues of joinder, intervention and consolidation may be critical in a case. If not provided for, the parties may be forced to participate in several parallel arbitrations involving many of the same parties and/or issues. Parties, however, should ensure that in situations where consolidation or joinder is a strong possibility, special attention is given to ensuring that the other elements of the arbitration clause are consistent from agreement to agreement (i.e., choice of law, location, number of arbitrators). Some jurisdictions (e.g., the Netherlands) empower judges to compel consolidation of related arbitration matters. However, in most situations, in order to obtain the desired result of one multi-party proceeding, the only reliable method is to draft the arbitration clause in each and all related contracts so that, when the issues of fact are related, all parties thereto are mutually obligated to submit to the same proceeding.

I. Timing of Proceedings

In many cases, parties can foresee a need to move through the arbitration process quickly. In such instances, the parties can draft an expedited process calling for a final award within a short time frame or invoke the optional procedures of an institution for expedited procedures. These can be changed by agreement of the parties if an expedited process is not needed when a dispute does arise. However, it is important to avoid setting unrealistic time schedules that can jeopardize the enforceability of an award that fails to meet such an aggressive timetable.

J. Confidentiality

While certain administrative bodies require confidentiality of the administrative institution and the arbitrator(s), the rules of the major institutions do not restrict disclosure by the parties or counsel. Additionally, certain nations (such as England) imply an obligation of confidentiality in arbitration proceedings. However, selection of arbitration alone does not guarantee confidentiality in most circumstances. If desired, the parties should expressly provide for confidentiality. When confidentiality is desired, language such as the following should be inserted: “Neither a party nor an arbitrator may disclose the existence, content, or results of any arbitration hereunder without the prior written consent of both parties or unless required to do so by law or order of a court.”

K. Qualifications and Neutrality of Arbitrators

In highly specialized contracts, it is common to provide in the arbitration agreement that all arbitrators must meet certain qualifications (i.e., education, experience, nationality or other expertise). For example, depending on the type of dispute, a certified public accountant, a lawyer, a retired judge or an industry executive might be the preferred decision-maker. In some instances, it might be better to specify that one of the three be, e.g., an accountant, rather than turn the entire proceeding over to three accountants. The parties could specify that the arbitrator be a certified public accountant if the issue is merely valuation, or an industry executive if the dispute is over contract interpretation. The parties might wish to specify that the arbitrator should, or should not, be a national or citizen of a particular country.

L. Interim Relief

Most arbitration rules expressly provide for recourse to courts and arbitrators for interim relief (e.g., ICDR, LCIA, World Intellectual Property Organization (WIPO), UNCITRAL and ICC). In addition, many rules now provide for the expedited appointment of an emergency arbitrator to decide urgent questions of interim or injunctive relief prior to formation of the arbitral tribunal. Whenever the potential need for interim relief can be anticipated, parties should avoid selecting a venue where the national laws disfavor interim relief in arbitration.

M. Limitation on Damages

Parties may wish to limit the remedies available to the arbitrators. For example, arbitrators can be stripped of any ability to award punitive damages, consequential damages, injunctive relief or awards in excess of a specific dollar amount. The parties can agree to a liquidated damage figure and an applicable interest rate.

One of the principal reasons parties, especially non-U.S. parties, select arbitration is to avoid excessive damage awards. Despite some state jurisdictions (e.g., New York) prohibiting arbitrators from awarding punitive damages, parties sometimes include provisions forbidding the award of such damages. This is particularly true of parties with assets in the U.S., since punitive damage awards are generally held to be against the public policy of most foreign countries. The ICDR Rules provide that the parties are deemed to waive their right to punitive damages by adopting the rules.

N. Attorneys' Fees and Costs

The costs of arbitration can also be dealt with in the arbitration clause. The parties may provide for each party to bear its own costs and attorneys' fees, require that the loser pay all costs and fees, or allow the arbitrators discretion to apportion costs as they deem appropriate. Most international institutions provide that the arbitrators have discretion to award costs of arbitration, including attorneys' fees, unless the parties' agreement expressly states otherwise.

O. Finality/Appeal

Different jurisdictions have different rights of appeal and challenge in relation to arbitration awards. Some permit an award to be challenged (in the courts of the place of arbitration) on the basis of an error of law. But it may be possible for such provisions to be excluded. For example, section 69 of the English Arbitration Act permits a challenge on the basis of a mistake of law to an English arbitration award, but the Act expressly states that this section may be excluded. Some rules, such as those of the ICC and the LCIA, provide that the parties agree to waive any rights of appeal, and this would be enough to exclude, e.g., section 69 of the English Act. Other rules, such as those of UNCITRAL and the AAA-ICDR, do not exclude such rights of appeal. Accordingly, if these rules are adopted, parties may wish to consider whether they wish to expressly exclude such rights in their arbitration clause. In most jurisdictions, however, challenges based on lack of jurisdiction or serious procedural irregularity, such as those permitted by article 34 of the UNCITRAL Model Law, may not be excluded.

On the other hand, some parties, following a bad arbitration experience, attempt to broaden the rights of the parties to appeal an unfavorable award. In the U.S., the Supreme Court has ruled that parties cannot expand by agreement the grounds for appealing an international arbitration award. Specifically, the court held that contractual arbitration agreements providing for judicial review broader than the grounds in the Federal Arbitration Act (FAA) are not enforceable under the FAA. Rather, when the FAA is invoked, a court "must" confirm an arbitration award unless it finds that one of the grounds set out in §§10 and 11 for vacating or modifying awards is applicable.

P. Confirmation or Entry of Judgment Clause

Consent to entry of judgment by an enforcement court is relevant to contracts that provide for arbitration in the U.S. or where enforcement may be sought in the U.S. The FAA, 9 U.S.C. §9, provides: "If the parties in their agreement have agreed that a judgment of the court shall be entered upon the award …" then the courts may confirm the award. In light of this language, some U.S. courts have held that in the absence of an express declaration by the parties empowering courts to enter judgment upon an arbitral award, the courts lack jurisdiction to enforce arbitral awards under the FAA. There is case law in the U.S. that, in the context of international contracts subject to the New York Convention, no consent to entry of judgment is needed. However, for the avoidance of doubt, it is advisable to add the following clause to contracts that provide for arbitration in the U.S. or for contracts where enforcement may be sought in the U.S.: "Judgment upon any award(s) rendered by the arbitrators may be entered in any court having jurisdiction thereof."

Q. Mediation

Mediation is becoming increasingly popular as a cost-effective means of resolving disputes. Since mediation is the least adversarial method of dispute resolution, a successful mediation can actually strengthen an ongoing commercial relationship. Mediation can be used either on its own or in conjunction with litigation or arbitration. Some dispute resolution clauses call for the parties to attempt to resolve disputes through mediation before proceeding to either arbitration or litigation. A professional mediator stakes his or her reputation on his or her ability to procure compromise through blandishment, threat or artifice. The success of such mediation, however, ultimately depends upon the parties' willingness to make concessions.

In contrast to a court or arbitration tribunal, which provide a binding decision based on the evidence and the applicable law, the mediator's role is to explore options with the parties, to find a mutually acceptable resolution that is based on their interests and their freedom to choose an outcome that considers their future as well as their past conduct.

The mediator's function is to help the parties examine options for mutual gain and find a mutually acceptable resolution. Our experience has shown the value of mediation if the parties are open to considering settlement – which is not always the case at the initial stages of a dispute – and are willing to engage a skilled mediator in a cooperative effort to seek a mutually acceptable resolution of their dispute without the costs and delays of litigation or arbitration. If the parties reach a mutually acceptable resolution, it is recorded in an enforceable contract.

Mediation can be used for any kind of dispute; there is no need to wait until a dispute results in formal legal proceedings. When the parties come to an eventual agreement, the parties themselves will put the agreement in writing and sign it so that it then becomes a binding contract.

Parties to mediation typically enter into a pre-mediation contract. This simple contract should include the following:

- The mediation should be confidential and non-binding.
- The parties should agree on who will conduct the mediation and how the mediator will be paid. The cost of the mediator is typically split between the two parties.
- The parties should agree on the length of the mediation. Most mediation is scheduled for a day, with larger cases sometimes providing for sessions of two days.
- The parties should agree to mediate in good faith until either party reasonably determines that it is fruitless to continue. If the parties cannot reach an agreement, the mediation will result in what is known as an impasse.

In larger cases, mediators typically request a pre-mediation submission in writing, and sometimes request to meet with the parties privately prior to the mediation session itself.

The mediation session normally starts by the mediator listening to the parties make a presentation in a "plenary" session attended by the parties and their advisors. The mediator then typically meets separately with each party to build rapport and help them explore and better understand their interests, and develop options, based on that understanding, which can lead to a mutually acceptable resolution. The mediator identifies key issues, keeps the parties focused on their interests, asks targeted questions about the reality of what they are seeking, and brainstorms with them about options for mutual gain as a trustworthy intermediary. If requested, mediators may provide evaluative guidance and suggest options for settlement. The International Mediation Institute's Code of Professional Conduct (www.IMImediation.org) provides a useful summary of the bounds of the mediator's role.

The advantages of mediation over litigation or arbitration may be summarized as follows:

- Time: mediations can be organized on short notice and typically last no more than a day or two, often after short party submissions to the mediator on the merits of the dispute.
- Cost: negligible, or modest, incremental cost in contrast to the very substantial costs of litigation or arbitration.
- Face-to-face meeting of decision makers: A fundamental part of the mediation process, usually required by the mediator. In litigation or arbitration, this is not required and rarely occurs – which can contribute to unnecessary cost and delay in these processes.
- Confidentiality: All discussions with the other party and the mediator are subject to mediation confidentiality, and may not be produced or used as evidence in arbitration or other legal proceedings. In litigation or arbitration, submissions and statements are not confidential as to admissions by either side in the course of the proceedings, although arbitration proceedings may be confidential as to external parties (but the results subject to public disclosure).
- Relationship with the other party: Because of the involvement of the decision makers and intimate nature of the process, mediation can be less harmful to commercial interests with

the opposing party than other forms of dispute resolution. Even if the parties do not settle, willingness to mediate can preserve relationships.

- Ability to structure creative solutions: Mediation provides the opportunity to reconcile overlapping interests the parties may have failed to recognize on their own, and structure settlement accordingly. Judges and arbitrators can only award or reject what is claimed or counterclaimed, usually monetary sums.

Mediation enjoys such high success rates because the parties are brought together in an environment where they can freely and confidentially present their position in front of a neutral third party. Participants often feel much better after having an opportunity to get things “off their chest”, and also benefit from hearing the other party’s point of view. The neutrality and more relaxed atmosphere of mediation may eliminate the desire to continue hostile litigation once both parties have seen all the issues in a more balanced light.

Part Two: Resolving Disputes in the Courts of Key Territories of the Luxury Brand and Fashion Industry

I. Introduction

It would be somewhat unwieldy in a handbook such as this to cover the dispute resolution procedure in every jurisdiction in the world. In this section of the chapter, we have instead focused on territories that have been identified as key for the luxury brand and fashion industry, either because they are generally considered to be the big fashion capitals of the world, such as the UK, Italy, U.S., France, Australia and Germany; are territories whose residents are key consumers of luxury brands and fashion items, such as Japan, China and Hong Kong; or are up-and-coming players in the fashion industry, such as Brazil, Russia and Mexico.

For each of these territories, we have highlighted a number of factors relevant to the dispute resolution procedure, including an overview of the relevant legal system, how to commence proceedings, and the key elements to bear in mind when instigating proceedings, such as costs and discovery procedures. There is also a section on recognition of enforcement of foreign judgments, which are not always automatically recognized in every jurisdiction, and are of particular relevance when dealing with multi-jurisdictional, cross-border disputes, which can be prevalent in the luxury brand and fashion industry.

As mentioned previously in this chapter, the predominant claims brought in this industry are intellectual property-related claims. You will note that, in relation to some territories, we have included relevant or key cases that may bind future decisions in common law jurisdictions (or, at the very least, be taken into account when deciding a future claim). As some of the key territories are civil law jurisdictions, which do not operate on a system of precedent, it is less useful to include cases from those jurisdictions. However, cases have been included where they are informative about the way courts approach claims or disputes in this sector.

A. England and Wales

1. Legal System

This is a common law system based on precedent. So, where there are cases, the decisions of the courts are binding on future tribunals. While this is still an integral part of the English legal process, increasingly law is derived from domestic legislation, in the form of Acts of Parliament, and European Union (EU) legislation.

Parliament is sovereign: i.e., it can make any new law, and amend or repeal an existing law.

In addition, as a member state of the EU, England is also bound by the regulations, directives and decisions of the EU. The English courts can refer any questions as to the validity or meaning of EU legislation to the Court of Justice of the EU.

The Human Rights Act 1998 incorporates the European Convention on Human Rights into English law.

2. Commencing Proceedings

Civil court proceedings in England and Wales are governed by the Civil Procedure Rules (CPR).

A claimant begins an action by issuing a claim form (which contains a brief description of the claimant's claim) by lodging a number of copies at court, together with a fee. The matter is then listed with a case reference, and must be served on the defendant within four months, unless permission for service out of the jurisdiction is given, in which case the deadline is six months.

To determine whether a party can serve proceedings outside the jurisdiction and, if so, how to effect service, it is useful to consider the following questions:

(a) Does the English court have jurisdiction to resolve the dispute?

(b) If so, is there an alternative to serving the defendant outside the jurisdiction (e.g., service on a UK branch of a foreign defendant or by a contractually agreed method)? If there is no alternative, can the defendant be served outside the jurisdiction without permission[6]; or is the court's permission required?[7]

Effective service is a precondition to the exercise of the court's jurisdiction and will confer prima facie jurisdiction on the High Court. However, jurisdiction may be challenged if service was invalid under the CPR, or the relevant rules on jurisdiction under an international convention/regulation or the common law regime have the effect of depriving the English court of jurisdiction (e.g., if the parties agreed to submit their disputes to the courts of another jurisdiction or to arbitration).

Service can be effected by various means. Where service is not by fax or email, an original sealed copy of the claim form needs to be served; however, note that recent case law[8] has determined that service out of the jurisdiction had been validly effected where a photocopy of the claim form, not a sealed original, had been used. However, the judge in this case noted that parties to a claim would be well advised to continue the present practice of serving a copy of the claim form that bears a seal affixed by the court office. In addition, other case law has shown that where a claim form is delivered in compliance with the CPR, it will be considered served unless a sender makes it clear that they are not effecting service.[9] There is no requirement under the CPR for the words "*enclosed by way of service*".[10]

It is therefore prudent when serving a claim on a defendant to state clearly, as appropriate, that a claim is either being enclosed "*by way of service*" or "*for information purposes only, and not by way of service*", to prevent any confusion.

Once all parties have filed an acknowledgment of service or a defense, or the matter has been listed for hearing or judgment has been entered, members of the public can inspect and obtain copies of the particulars of claim and all subsequent statements of case, judgments and orders in the proceedings, unless the court orders otherwise.

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[6] CPR 6.33.

[7] CPR 6.36.

[8] *Weston v Bates and another* [2012] EWHC 590 (QB).

[9] *Asia Pacific (HK) Ltd v Hanjin Shipping Co Ltd* [2005] EWHC 2443 (Comm).

[10] *Hills Contractors & Construction Ltd v Struth & Anor* [2013] EWHC 1693 (TCC).

3. Key Elements of Litigation

If a defendant fails to acknowledge service or serve a defense, or the claimant fails to serve a defense to a counterclaim within the specified time limits, the other party can apply for judgment in default, unless there is an outstanding summary judgment or security for costs application.

A defendant can apply at any time to dispose of all or part of a claim without a trial, on the basis that the claim has no real prospect of success and there is no other compelling reason for a trial. It is preferable that such an application be made as early as possible, to save costs. Similarly, if the defendant does not have a strong argument to rebut the claim, the claimant can seek summary judgment.

Disclosure is an important and costly part of the litigation procedure. The court will make a disclosure order based upon the parties' submissions as to what is appropriate in the particular case. The court now has a range of options, from no order for disclosure to standard disclosure. Examples of documents that may have to be disclosed are letters, documents, memoranda, handwritten notes, diagrams, emails, computer records and voicemails that are relevant to the proceedings, even if they are commercially sensitive or harmful to the case of the party producing them. Actions often settle at the disclosure stage because it can bring to light information that may have an important bearing on the strengths and weaknesses of the parties' positions. When considering disclosure, the parties to the proceedings must take into account the number of documents involved, the significance of any particular document, and the ease and expense of retrieval. The exercise needs to be just and at proportionate cost to the amount in dispute, the issues and complexity of the case. Where there is a large amount of documentary evidence, the parties should consider the use of an e-disclosure provider. This may allow a party to narrow the overall review pool through keyword and date searches. In addition, there may be cost savings if the parties agree to use the same provider. Failure to comply with electronic disclosure requirements may lead to courts penalizing parties through costs orders, such as ordering parties to pay the wasted costs of their opponents if electronic disclosure obligations have not been taken seriously or if there are inadequacies in the process.

The parties will be directed to prepare and disclose to the other side, within a specified period, witness statements. Witness statements consist of the evidence that each party intends be given orally at the trial by their witnesses. Notwithstanding the fact that the statements have been put in writing, the witnesses will usually need to attend the trial to give evidence in person and to be questioned (cross-examined) by the other party's lawyer.

Each party may also be allowed to rely on evidence from one or more expert witnesses. They are required to name and submit costs estimates in relation to these expert witnesses. If allowed, each party will be required to exchange copies of their expert's report before the trial, and the court may order a meeting between the parties' expert witnesses to discuss any points on which they disagree. The parties also have the right to question each other's experts before trial.

The judge is the sole arbiter of fact and law.

While equitable remedies such as injunctions or specific performance are discretionary, legal remedies such as a claim for damages arising from a breach of contract or a tortious action are available as of right following determination of the substantive legal issues.

Equitable or legal relief may be sought in any action before a court. The High Court has the full range of legal and equitable remedies available to it and any of these may be sought by a claimant.

Remedies include:

i. damages;
ii. interim injunctions;
iii. freezing injunctions/orders; and
iv. search orders.

The CPR restrict a litigant's right to appeal and requires permission to appeal to be sought at all levels. The court will only give permission where it considers the appeal would have a real prospect of success or there is some other compelling reason why it should be heard.

4. Costs

Where the claimant is resident overseas, or is a company in financial difficulties based either in or outside of the jurisdiction, the defendant can ask for "security for costs". The basis of the defendant's request is that the claimant has insufficient assets in England and Wales and, therefore, if it fails in the action and is ordered to pay the defendant's costs, it will be difficult for the defendant to enforce the order against the claimant. As a result, the court may order the claimant to give security. This is done by obtaining a bank guarantee or placing on deposit a sum representing the amount the defendant believes it will cost it to defend the claim. If the claimant and defendant can agree the amount of security, there is no need to apply to the court. It is not possible to obtain security against a resident of a member state of the EU or European Free Trade Area (EFTA); nor does security for costs extend to an insolvent individual in England and Wales.

Recovery of legal costs is at the discretion of the court. As a general rule, a successful party will be entitled to recover its proportionate costs, usually a significant proportion of the fees and expenses it has incurred in the litigation, from the other party.

If the claimant loses, it is liable for its costs and the defendant's costs, each of which may be substantial. If the defendant loses, it will have to pay both sets of costs and the amount the claimant is awarded by way of judgment. Claimants should be aware that a defendant, even if it has the means to satisfy a judgment, may not have sufficient funds to pay a large costs order. It is imperative, therefore, for all parties to consider very carefully the cost of litigation before commencing an action.

Further, if the opponent is legally aided, the successful party may not be able to recover any costs. In practice, commercial entities will usually only deal with a legally aided claimant, because a defendant in receipt of legal aid will usually not be worth bringing a suit against in the first place.

Under the CPR, courts are encouraged to use a wide range of costs orders to encourage settlement and penalize non-cooperation. In addition to conditional fee agreements (CFAs), solicitors may enter into contingency fees, known as damages based agreements (DBAs), with their clients. DBAs allow for the legal fees to be paid from the damages recovered, subject to a cap of 50 percent in commercial cases and 25 percent in personal injury cases.

Professional third-party funders may also agree to fund the legal costs and disbursements, subject to a percentage recovery of any damages.

5. Enforcement of Judgments

If the claimant obtains a judgment, he or she will demand payment from the defendant of the amount ordered by the court. If the defendant refuses to pay, the claimant can seek to enforce the judgment in the following ways:

i. third-party debt orders;
ii. a charging order;
iii. a writ of execution;
iv. orders to obtain information from a judgment debtor (or in instances concerning a company, one of its officers);
v. presentation of a petition to wind up a company defendant or to declare bankruptcy for an individual defendant; and
vi. attachment of earnings.

When considering the procedure for enforcing the judgment of a foreign country's court in England, there are three categories of foreign judgment that need to be distinguished:

i. Judgments from countries that are bound by the Brussels Regulation or are signatories to the Lugano Convention 1988. Essentially, these are judgments from the EU and EFTA member states.
ii. Judgments from countries with which the UK has bilateral conventions. These are given effect in the UK by the Administration of Justice Act 1920, which essentially covers judgments from most countries within the Commonwealth, and the Foreign Judgments (Reciprocal Enforcement) Act 1933, which covers judgments from Australia, Canada and Guernsey, among others.
iii. Judgments from countries with which the UK has no such convention, which include some of the major trading nations: e.g., the U.S., Japan and the Commonwealth of Independent States (CIS) countries.

Judgments in the first and second categories are, however, quicker and easier to enforce than those in the third category.

Under the Brussels Regulation and the Lugano Convention, enforcement is almost automatic, and there is no question of reassessing the merits of the case, other than in very limited circumstances, such as public policy reasons or failure to serve the defendant with the proceedings.

A judgment that is to be enforced must be final, for a specific sum of money, not in respect of taxes or fines, and not obtained by fraud or in breach of a jurisdiction or arbitration agreement.

Where there is no reciprocal enforcement treaty with the foreign country, enforcement is governed by the common law rules. The foreign court must have acted with jurisdiction to render the judgment, and this will be judged by English rules of conflicts of laws.

6. Arbitration

All domestic or international arbitrations that have their seat in England and Wales are governed by the Arbitration Act 1996, which provides that the courts will enforce arbitration agreements and compel parties to arbitrate where the parties have agreed to do so. It is worth noting that recent case law has determined that a clause in a contract that purported to prevent the parties to the contract from arbitrating a dispute without first seeking to resolve the dispute by friendly discussion was enforceable under English law.[11]

Any court proceedings will be stayed to allow the arbitration to take place. The only grounds for refusing to stay court proceedings are that the arbitration agreement is null and void, inoperable or incapable of being performed.

The courts have power to order security for costs (unless the parties agree otherwise), although no criteria for the exercise of this power are given in the Act.

The court also has power (unless the parties have agreed otherwise) to take evidence from witnesses, to preserve evidence, and to grant interim injunctions, such as freezing injunctions and search orders. However, except in cases of urgency, the court will only act on a party's application if either the other party or the tribunal gives consent, and if the tribunal either does not have the same power, or is unable to exercise it effectively.

An English arbitration award may, on application to the court, be enforced in the same manner as a judgment of the court.

An arbitral award is final and binding on the parties and can only be set aside by the court in very limited circumstances. The grounds on which an award may be set aside or varied are as follows:

i. substantive jurisdiction;
ii. serious irregularity; and
iii. appeal on a point of law.

7. Alternative Dispute Resolution

The leading provider of ADR services in England is the Centre for Effective Dispute Resolution (CEDR), based in London. CEDR provides a full range of ADR services and also offers one of the most highly valued mediator training courses.

The increasing importance of ADR can be shown in recent case law where the courts have penalized the defendants by issuing an onerous costs order as a result of the defendants consistently refusing to mediate a dispute.

B. United States

1. Legal System

The U.S. has a federal system with separate state and federal courts, based on the U.S. Constitution. Appeals from federal trial courts are made to circuit courts of appeals – the U.S. Supreme Court is the court of last resort. When state and federal law conflict within a given court system, the Supremacy Clause of the Constitution ensures that federal law prevails. The Constitution's Bill of Rights provide that certain basic legal rights are guaranteed in both court systems. The U.S. Supreme Court and the Supreme Court of each individual state have the power to prescribe the procedural rules that govern the conduct of cases in their respective courts.

[11] *Emirates Trading Agency Llc v Prime Mineral Exports Private Limited [2014] EWHC 2104 (Comm).*

2. Commencing Proceedings

A federal court must have subject and personal jurisdiction before hearing a case. Subject jurisdiction is the power of a court to hear the case, and personal jurisdiction refers to the power of the court to hear a case relating to a specific person or item of property. This concept has been developed by case law. District courts look to whether the cause of action arose in the jurisdiction, whether the defendant resides or does business in the jurisdiction, or whether there is express or implied consent to jurisdiction in a contract or by owning property, or whether the defendant appeared voluntarily in the jurisdiction and was served while there.

To begin a civil lawsuit in federal court, a plaintiff files a complaint with the court and then serves a copy of the pleading on each defendant. This must contain a statement of the basis on which the court's jurisdiction depends, a statement of the claim showing that the pleader is entitled to relief, and a demand for relief.

Proper service requires that the process (i.e., the complaint and summons) be provided to the defendant in a manner that ensures notification of the lawsuit. The Federal Rules expressly permit service on a foreign defendant, but require that such service be accomplished pursuant to any applicable international treaty.

A defendant served with a complaint must file a response to the complaint. Failure to do so will result in a default judgment against the defendant for the relief demanded by the plaintiff in the complaint. A defendant may assert claims it has against the plaintiff in a counterclaim, and claims that it has against another defendant in a cross-claim. Counterclaims are either compulsory or permissive. If the lawsuit proceeds to judgment, a defendant who has not filed a compulsory counterclaim will be barred from later pursuing the claim as a separate lawsuit.

A person must be joined as a party to the suit, provided it will not deprive the court of subject matter jurisdiction, if:

i. in the person's absence, complete relief cannot be granted to those who are already parties;
ii. the person claims an interest in the subject of the action, and that interest may be impaired if the person is not joined; or
iii. both the person and others who are already parties to the suit claim an interest in the subject of the action, and the failure to join the person will create a substantial risk of inconsistent determinations.

3. Key Elements of Litigation

The Federal Rules of Civil Procedure govern the procedure to be followed for all civil actions filed in all federal district courts.

Discovery, including electronic discovery, is a procedural option for parties to obtain information about the case prior to trial. The purpose of discovery is to ascertain facts and also limit issues and preserve evidence for trial. The scope of discovery is broad and does not need to be directly relevant to the claims.

The scope of discovery is limited by attorney–client privilege. Additionally, a party may object to disclosure of a trade secret or other confidential commercial information. An attorney's impressions, conclusions or legal theories are also specifically protected from disclosure.

A party may object to discovery when the information sought is privileged, or if disclosure would result in embarrassment, undue burden or expense, or to protect its trade secrets and other confidential proprietary information, and can apply for a protective order. The court will ultimately decide what information is discoverable.

Mandatory disclosure requires parties to proceedings to disclose certain basic information that is needed in most cases to prepare for trial. Parties must disclose information regarding potential witnesses, documentary evidence, damages and insurance.

A party seeking discovery may petition the court for an order compelling further responses, documents or compliance with requests. Parties can take depositions from witnesses by telephone or other remote electronic means. Videotaped depositions can offer many advantages. Upon written request, a party may inspect, copy, test or sample documents or electronically stored information in the possession or control of another party to the litigation. Parties are obligated to take reasonable steps to preserve and then produce information stored on computers.

A motion for summary judgment means the onus is on the opponent to provide sufficient evidence for its claims or defenses to create a genuine issue of fact. The motion can be used to dispose of all or any part of the opposing party's claims or defenses. It can dispose of claims or defenses having no factual support, as well as those in which the facts are undisputed, or turn solely on issues of law.

Class actions allow claimants to aggregate their claims into a single lawsuit against one or more defendants. The scope in terms of discovery and cost of defending them is matched by the monumental exposure they pose to defendants; as a result, many class actions result in settlement.

Litigants have the choice of a trial conducted by the judge (non-jury trial); or filing for a trial by jury, where the matter is decided by a jury of not fewer than six but not more than 12 individuals (in a civil case).

Remedies available:

i. damages;
ii. preliminary injunction;
iii. specific performance;
iv. rescission; and
v. other remedies – prejudgment or provisional.

Appeals against district court judgments are taken to the Court of Appeals. Interim orders of the district courts that do not bring litigation to a conclusion are not immediately appealable except in limited circumstances as a matter of right, such as orders denying, modifying or extending injunctions.

A party may appeal to the Supreme Court only in very limited circumstances, such as a declaration of an unconstitutional Act of Congress.

4. Costs

A court will order an American defendant, who has failed to waive formal service requirements, to pay the costs incurred by the plaintiff in effecting service, unless the defendant can demonstrate good cause for the failure. Whether compulsory or permissive, a counterclaim may claim relief exceeding the amount claimed by the opposing party or claim a different kind of relief than that sought in the pleading of the opposing party. Punitive damages are a focal point of debate in the U.S., with many arguing that punitive damage awards can be excessive.

The general rule in the U.S. is that each party is responsible for paying its own attorney fees, regardless of the outcome of the litigation. The courts recognize the rights of parties to agree to fee-shifting provisions in contracts. In limited situations, the court may impose attorney fees and other sanctions for certain forms of misconduct by a party or the party's attorney. Under the Federal Rules, costs are awarded as a matter of course to the prevailing party unless the court otherwise directs, but these costs generally do not include attorney fees. Recovery of costs is limited to:

i. certain court fees;
ii. court reporter fees;
iii. witness fees and expenses;
iv. printing and copying fees;
v. certain docket fees; and
vi. fees for court-appointed experts and interpreters.

5. Enforcement of Judgments

To be given effect, a judgment must be set forth in a separate document that is filed with the court clerk and entered into the court docket in accordance with procedures prescribed by the Federal Rules. The court clerk must serve notice of entry of the judgment by mail upon each party who is not in default. A defendant who fails to respond to a pleading within the time designated for response is in default and thus subject to entry of a default judgment.

The district court, on the motion of a party, may also relieve a party from a final judgment, order or proceeding, upon a showing of:

i. mistake, inadvertence, surprise or excusable neglect;
ii. newly discovered evidence;
iii. fraud or other misconduct of the adverse party;
iv. a void judgment, release or discharge of the judgment; or
v. any other reason justifying relief.

After a judgment awarding damages is rendered, the successful party becomes the judgment creditor and the opposing the judgment debtor. If the debtor fails to satisfy a money judgment, the creditor may enforce the judgment through a writ of execution, directing an officer of the court to seize the debtor's property and transfer the proceeds to the judgment creditor.

When a judgment directs a party to perform a specific act, the court has several options available to assure that the party complies. If a party fails to perform the act within the time ordered by the judgment, the court may:

i. appoint another person to carry out the defendant's obligation and order the act to be done at the defendant's expense;
ii. issue a writ of attachment or a sequestration against the property of the defendant to compel obedience, or enter judgment divesting the defendant's title in the property;
iii. find the defendant in contempt; or
iv. issue a writ of execution as to the property, if applicable.

The court may direct the disobedient party to pay the costs of performing the act required by the judgment.

In certain situations, the Federal Rules permit enforcement of orders by or against persons who are not parties to an action. Generally, these participants are treated as if they were actually parties, and any rules that apply to named parties similarly apply to them

Recognition and Enforcement of Foreign Judgments

The laws of individual states govern the recognition and enforcement of foreign judgments, and the U.S. has not entered into any treaties providing for recognition or enforcement of court judgments from other countries.

The majority common-law view of the states is that judgments of foreign countries are entitled to recognition and enforcement generally to the same extent as sister-state judgments, with some additional barriers to enforcement. Once a court in one state has recognized a foreign judgment, that domestic court's decision is entitled to the full faith and credit of the other states.

In actions for the recognition of foreign country money judgments, the court will first look to common law concepts or to one of the Recognition Acts (if enacted in that state) to determine whether the foreign money judgment should be recognized. The Recognition Acts encompass any foreign country judgment granting or denying recovery of a sum of money. To be recognized, the foreign country money judgment must be final, conclusive and enforceable in the jurisdiction in which it was rendered.

6. Arbitration

The FAA provides that any transaction involving interstate or international commerce may be settled either by an arbitration based upon a written provision contained in the contract, or by an agreement in writing to submit an existing commercial dispute to arbitration. Written arbitration provisions and agreements are valid, irrevocable and enforceable, except when, at law or in equity, grounds exist for the revocation of any contract.

Arbitration clauses are presumed to be enforceable, and any doubts concerning the scope of an arbitration clause are resolved in favor of arbitration. The grounds for avoiding application of an arbitration clause are principally those used to avoid enforceability of any contract – fraud, duress, waiver or unconscionability. The application of these defenses to an arbitration clause is extremely narrow and circumscribed.

Arbitrators, like judges, have the power to decide cases. Arbitrators have extensive power and discretion in conducting a hearing and over the finality given to an award. Arbitrators are not strictly bound by case precedent or statutory law. Instead they are guided in their analysis by the underlying principles of the law and are given wide latitude in their interpretation of legal concepts.

The role of U.S. courts in the arbitration process is limited. Once a court has found the existence of an enforceable arbitration clause between the parties, it must stay the court proceeding and compel arbitration. A party may pursue injunctive relief before commencing an arbitration without waiving either party's right to arbitrate the dispute. A party seeking to contest (vacate) an arbitral award may petition the court in the district where the award is made, on the following grounds:

i. it has been procured by corruption, fraud, or illegal means;
ii. there has been evident partiality or corruption in any or all of the arbitrators;
iii. the arbitrators have been found guilty of misconduct in refusing to postpone the hearing, refusing to hear pertinent evidence material to the controversy, or of any other behavior by which the rights of any party have been prejudiced; or
iv. the arbitrators have exceeded their powers.

For international arbitration, various states have enacted statutes based on UNCITRAL, which allows courts to order interim measures of protection even if the place of arbitration is located outside those states. In an international arbitration, any party may petition the court to enforce the award. It will be enforced provided the petition is within three years of the award, unless it falls within one of the grounds for refusing enforcement set out in the New York Convention.

C. Australia

1. Legal System

The primary source of law in Australia is the enactments by the Commonwealth and State Parliaments, but common law, inherited from the English courts and developed in Australia, is also an integral part of the country's legal system.

2. Commencing Proceedings

By engaging the assistance of the courts to resolve a dispute, the parties submit to procedural requirements set out in court: e.g., on timelines for pleadings, discovery of documents, interrogatories and production of witness statements and affidavits.

Each state and each court in Australia has its own particular rules governing the procedural aspects of litigation (although litigants tend to face similar rules and regulations).

3. Key Elements of Litigation

Compulsory pre-trial mediations are an important part of the court process. These aim to bring parties together in an attempt to resolve their differences and arrive at a mutually agreeable settlement.

All parties to civil proceedings in Victoria now owe a paramount duty to the court to further the administration of justice, and are subject to explicit obligations, including to act honestly, to exchange critical documents at an early stage, and not to engage in conduct that is likely to mislead or is vexatious. Similar provisions exist in both New South Wales and the federal jurisdiction.

There are wide variations in the time taken to bring a dispute to trial. With urgent cases in some jurisdictions, a final hearing weeks, or even days, after the commencement of proceedings is possible. More commonly in the Federal and Supreme Courts, it takes a period of a year or more from pleadings being filed to the trial being heard.

Depending on the size, complexity and urgency of the matter before the court, the time it takes for a judgment to be delivered after submissions have been made varies widely. In some instances, an impromptu judgment is given without preparation. However, it is more common for judges to reserve their decision, and they sometimes spend a number of months drafting reasons for judgment, which are published at or after the determination of the matter.

Remedies

(a) Equitable or legal relief may be sought in any action before a court. The ability of courts to order the full range of either equitable or legal remedies depends on the particular rules and legislation governing their jurisdiction.
(b) In the case of the High Court of Australia and the State Supreme Courts, the full range of legal and equitable remedies are available and may be sought by the applicant.
(c) While equitable remedies such as injunctions and specific performance are discretionary, legal remedies such as a claim for damages arising from a breach of contract or a tortious action will be available as of right, following determination of the substantive legal issues.
(d) Remedies include:
    (i) Interim injunctions: to preserve the status quo pending final determination of the rights of the parties in the action.
    (ii) Mareva injunctions: to restrain a defendant from removing assets from the jurisdiction.
    (iii) Anton Piller Orders: to prevent a defendant from destroying evidence in his or her possession before trial.
    (iv) Other interlocutory orders may be available for the detention or preservation of the subject matter of the action, the sale of perishable property, recovery of personal property claimed in the action but subject to a lien, or the appointment of a receiver of property.

An application to a higher court may exist either as of right, or after consent for leave to appeal has been granted.

4. Costs

In Australia, it is usual for an unsuccessful litigant to be ordered to pay a portion of the costs of the successful party: i.e., costs "*follow the event*". The amount allowed is usually a reasonable amount for costs necessarily and reasonably incurred to bring or defend the case (party/party costs).

The successful party rarely obtains full reimbursement of all his or her costs; the proportion is generally about one half to two thirds of the actual costs.

In some circumstances, a court may award "indemnity costs". This does not extend to all costs but is greater than party/party costs.

In many cases, costs are agreed between the parties after negotiation. If not, they are determined by the court assessing a bill of costs.

An offer of compromise, or offer to settle, may be made by any party to an action in all jurisdictions except the Australian Capital Territory. In all other jurisdictions, the procedure for such offers has taken the place of the rules that formerly permitted payment into court, but that in those jurisdictions has now been repealed. The policy of the rules providing for these offers is to encourage the party to whom a fair and reasonable offer has been made to accept the offer and bring the proceedings to an end. If the offer is not accepted by the opposing party, and they then fail to obtain a judgment that is more advantageous than the offer they received but did not accept, then the opposing party can be ordered to pay the costs of the offering party who made the offer that was rejected. Therefore, even if the opposing party is successful at trial, they can still be penalized in costs for failing to accept an offer that was made to them.

A foreign plaintiff without assets in Australia may be required to give security for the proportion of the defendant's costs that he or she may have to pay if he or she is unsuccessful in the action. Security can be given by a payment into court or by bond. There is no requirement for a defendant to give security, except where a counterclaim is made by a foreign defendant without assets in the jurisdiction, or where the defendant is an appellant in an appeal.

Where a creditor is owed money by a company, it may be possible for the creditor to serve a statutory demand for payment pursuant to the provisions of the Corporations Act 2001 (Cth). While there are technical rules governing the types of debts that are covered by a statutory demand, in general terms the claim must be for a liquidated amount that is presently due and payable and greater than AS$2,000, and may, e.g., consist of a judgment debt. A debtor served with a statutory demand will have 21 days to comply with it or otherwise file an application with the court to set the statutory demand aside. If the debtor fails to do so, a statutory presumption arises that the debtor is insolvent, and the creditor may then bring an application seeking an order that the debtor be wound up in insolvency.

5. Enforcement of Judgments

The rules concerning enforcement of judgments depend on whether the successful party is endeavoring to recover from a party resident intrastate, interstate or overseas.

With enforcing judgments at a local level, there are a range of statutory provisions to compel the compliance of an unsuccessful party. The modes of enforcement will necessarily be defined by the nature of the particular claim.

The principal methods of enforcement of judgment debts or the carrying out of orders of the court are:

i. a writ of execution (to seize and sell the defendant's goods to satisfy the judgment debt);
ii. a petition to wind up a company or to declare bankrupt an individual;
iii. examination of the judgment debtor (or where it is a company, one of its officers) by oral cross-examination on its property or means of satisfying the judgment. The judgment debtor can be required to produce relevant books or other documents;
iv. garnishee proceedings, where debts due to the defendant may be ordered to be paid directly to the plaintiff;
v. a charging order, by which a charge in favor of the plaintiff is imposed on an interest in land or securities owned by the defendant; and
vi. appointment of a receiver over the defendant's interest.

Recognition and Enforcement of Foreign Judgments

Australian courts can recognize and enforce a foreign judgment at common law, subject to a number of conditions and possible defenses. This jurisdiction is especially important in relation to those countries (such as the U.S.) that are not parties to reciprocal enforcement of judgment arrangements with Australia.

There is no statutory power in Australia to recognize and enforce judgments of courts in such non-treaty countries.

The most important conditions for common law enforcement of judgments in Australia are:

i. The foreign court must have exercised a jurisdiction that the Australian court will recognize under its own conflicts of law rules.
ii. The foreign judgment must be final and conclusive. This does not mean it cannot be subject to appeal. If an appeal is pending, this may give grounds for an application to stay or adjourn the enforcement proceeding in Australia.
iii. The judgment must be for a fixed debt or a definite sum of money. For example, an order for specific performance contained in a foreign judgment will not be enforced by the Australian courts.
iv. The parties to the foreign judgment and to the enforcement proceedings must be identical.

Once the Australian court confirms it has jurisdiction, the merits of the case cannot be reopened. However, certain recognized defenses to enforcement are available in the Australian courts. They include:

i. foreign judgment was obtained by fraud or by duress;
ii. the foreign court acted contrary to natural justice; and
iii. enforcement of the foreign judgment would be contrary to public policy.

At both the federal level and state level, there is legislation providing for the direct execution of foreign judgments.

If any of this direct enforcement legislation applies to any particular foreign judgment, it must be used in preference to any common law action. All of this legislation is based on a scheme of an initial "registration" of the foreign judgment in the appropriate State Supreme Court or the Federal Court of Australia.

Registration requires proof that the foreign judgment:

i. is one to which the relevant Act applies. The legislation in each case lists the countries and courts to which it extends. As a general rule, there is good coverage of Commonwealth countries but, otherwise, the application of any particular legislation depends on the existence in the foreign country of reciprocal enforcement treaties;
ii. is final and conclusive. As with common law enforcement, the fact an appeal is pending is not conclusive, but may be sufficient to justify an adjournment of the registration proceedings;
iii. generally must be for a money sum and not be in respect of taxes or a fine or penalty; and
iv. is enforceable in the foreign country by execution.

6. Arbitration

1.1 In Australia, international arbitration is governed exclusively by the International Arbitration Act 1974 (Cth). Domestic commercial arbitration in each state is governed by Uniform Commercial Arbitration legislation.

The IAA now incorporates the UNCITRAL Model Law on International Commercial Arbitration (the Model Law), with the exception of interim measures where the opposing party was absent or not represented.

Domestic arbitration in Australia is governed by the Uniform Commercial Arbitration Acts (UCAA). The new UCAA include the Commercial Arbitration Acts of all states except the Australian Capital Territory. These states have adopted the Model Law as outlined in the Commercial Arbitration Bill 2010 (Cth). In the Australian Capital Territory, the superseded Commercial Arbitration Acts are still in force.

Courts will enforce arbitration agreements, compel parties to arbitrate where they have agreed to do so and stay court proceedings to allow the arbitration to take place.

In respect of international arbitrations, the courts have powers vested to them by virtue of the Model Law.

An award made under an arbitration agreement will be enforced in the same manner as a judgment of the court.

In addition, it may be enforced under the New York Convention.

Arbitral awards falling outside the categories above may be enforced under common law.

7. Alternative Dispute Resolution

Many companies prefer to avoid litigation. Court proceedings can be expensive and time consuming. In addition, due to their public nature, it is harder for commercial confidentiality to be maintained.

The most popular form of ADR is mediation.

Another frequently used method of ADR is expert determination, where the parties agree to be bound by the decision of an independent third party. The expert must act fairly, and will usually accept written submissions but do not take any evidence. This is best suited to cases of a technical nature that do not involve large sums of money.

8. Interesting/Relevant Cases

a. *Seafolly Pty Ltd v Fewstone Pty Ltd* [2014] FCA 321

The claimant, Seafolly Pty Limited (Seafolly), brought proceedings against the defendant, Fewstone Pty Limited (City Beach), alleging a breach of sections 14, 31(1)(b) and 36 of the Copyright Act 1968 (Cth) for reproducing a “substantial part” of Seafolly’s swimwear designs without permission. City Beach acknowledged that it had purchased Seafolly’s garments to inspire its designers, but denied any copyright infringement, contending there was no sufficient objective similarity between the parties’ designs and that any parts taken from the Seafolly artworks were not substantial in the relevant sense.

The Federal Court acknowledged there were a number of differences between each of the designs. However, the court said it was not appropriate to dissect the copyright work piecemeal and focus on the differences, or that the two works bear an overall resemblance to each other; the correct test for this kind of copyright infringement is whether there is reproduction of a substantial part of the expression of the copyright work in a qualitative sense.

The court held City Beach to have infringed Seafolly's copyrights, as, although the designs were not an exact reproduction, there were a number of significant similar design elements in the selection, arrangement and combination of elements within the works as a whole. Accordingly, City Beach was ordered to pay damages in the sum of $250,333.

This case serves as a warning to fashion designers to tread carefully when using other brands' designs as inspiration for their own garments.

b. *Review Australia Pty Ltd v Innovative Lifestyle Investments Pty Ltd* [2008] FCA 74

The claimant, Review Australia Pty Limited (**Review**), registered a dress design under the Designs Act 2003 (Cth). The defendant, Innovative Lifestyle Investments Pty Ltd (Innovative), began to manufacture and sell a similar dress, leading Review to bring Federal Court proceedings against it for infringement of their registered design.

The court, in finding Innovative to have infringed Review's intellectual property rights, acknowledged that a designer may have a certain reputation in the market that may be diluted by replicas. This was particularly relevant here, as the perceived originality of Review's garments was important for its image in the market and, therefore, the presence of Innovative's similar dress in the market brought about a "*minor dilution*" of Review's reputation. Innovative was made to pay $17,500 in damages, including $10,000 of additional damages.

This decision is a reminder that designers need to remain alert to any copying of their products, as well as implement the necessary steps to protect their intellectual property

c. *Adidas AG v Pacific Brands Footwear (No 3)* [2013] FCA 905

Adidas AG (Adidas) owned two trademark registrations (each and together the 3 Stripes Registrations), containing endorsements stating that the trademark consisted of three stripes forming a contrast to the basic color of the shoe. It alleged that this was infringed by the defendant, Pacific Brands Footwear (Pacific Brands), as a result of the four stripes used on the side of shoes imported and sold by Pacific Brands in Australia.

Pacific Brands denied any infringement, on the basis that the four stripes on its shoes were not used as a trademark, that they were not deceptively similar to the 3 Stripes Registrations, and that the fame of these registrations meant that the four stripe marks would never be deceptively similar.

The court held that the four stripes on the Pacific Brands shoes were used as a trademark and that some of the shoes, in considering the overall impression of the stripes of contrasting colors, gave rise to a real and tangible danger of confusion occurring. Therefore, Pacific Brands was found to have infringed the 3 Stripes Registrations on three of the Pacific Brands Shoes.

This case shows that motifs, designs and devices adopted in the fashion industry for decorative purposes can also function as a trademark that can be registered and enforced against infringers. It also provides a warning for sellers of "look-alike" fashion products, and indicates that device mark registrations for decorative elements of clothing and footwear are a worthwhile investment to protect the trademark, and be able to enforce the registration against infringers.

d. *Louis Vuitton Malletier v Sonya Valentine Pty Ltd* [2013] FCA 933

The claimant, Louise Vuitton Malletier (Louis Vuitton), sued the defendant, Sonya Valentine Pty Ltd (SV), for trademark infringement under section 20 of the Trade Marks Act 1995 (Cth) and breaches of the Australian Consumer Law (ACL) for misleading or deceptive conduct under section 18, and false and misleading representations in respect of goods under section 29. SV imported and sold sunglasses bearing the mark LOUIS V, and a flower symbol. Louis Vuitton had registered trademarks for LOUIS VUITTON and a flower symbol in respect of luxury goods including sunglasses.

The court found the flower symbol to be deceptively similar to the registered trademark, but that LOUIS V was not, as it did not believe a consumer would be deceived into thinking that the "V" stood for "VUITTON". The relevance of reputation was considered when assessing the infringement, and it was decided that Louis Vuitton's mark did not meet the high standard necessary to take reputation into account in determining infringement.

It was held, however, that the combined use of the flower symbol and LOUIS V was misleading under section 18 of the ACL, and reputation was seen to be relevant here, as a consumer may be deceived into believing that the sunglasses were associated with Louis Vuitton, given the company's reputation.

It was also held that the statement on the sunglasses "Eyewear est. 1941 Paris" amounted to a false or misleading representation in breach of section 29(1)(k) of the ACL, as there was no evidence to suggest any connection to Paris.

This case highlights that where there is a registered trademark, it is still worthwhile to plead both trademark infringement and misleading or deceptive conduct. It also demonstrates the importance of establishing reputation, and the different role it plays in trademark infringement cases as opposed to ACL claims.

e. *The Polo/Lauren Co LP v Ziliani Holdings Pty Ltd* [2008] FCA 49

The claimant, Polo Lauren Co LP (Polo/Lauren), brought copyright infringement proceedings against the defendant, Ziliani Holdings Pty Ltd (Ziliani), in respect of Polo/Lauren's embroidered logo. Ziliani sold "Polo Ralph Lauren" garments in Australia that had been purchased overseas, without the consent of Polo/Lauren. The logo had been applied to the clothing with the consent of the respective owner of the copyright in the country of manufacture.

The case concerned whether a symbol, when lawfully embroidered overseas into an article of clothing, is protected by the Copyright Act 1968 (Cth) so that to import for sale or sell it in Australia without the consent of the respective owner of the copyright would be unlawful. Ziliani based its defenses on the Copyright Act, on the grounds that: (1) the logo was a non-infringing accessory within the meaning of the exception to infringement under section 44C, as it was a "label"; and (2) the logo was a "corresponding design", so could be reproduced without infringing copyright under section 77.

The first instance court looked at whether the logo, when embroidered on an article of clothing, was a "label" in the ordinary English meaning of the word, as within the definition of "accessory" under the Act. The judge held that that the natural meaning includes a brand name, trademark and the name by which a design or fashion house and its product is generally known. His Honour found that the logo was not primarily a decorative feature but that its primary function was to signify the manufacturer's identity and to convey that the article was authentic. It was said that section 44C had been introduced to prevent the inappropriate use of copyright, addressing past circumstances where distributors of goods attempted to control the market for their products by devising a label in which copyright subsisted, and could then claim copyright in the label to stop others from importing the goods. The trademark was also already adequately protected under the Trade Marks Act. As the logo in this case was a "label", the defense under section 44C was allowed.

The judge further held that the embroidered logo fell within the definition of "corresponding design", so Ziliani would also be successful in its defense under section 77.

On appeal, the court upheld the first instance court's decision with relation to the label issue. However, it held that the definition of corresponding design was intended to cover a situation where an artistic work is embodied in three dimensions; that "embody" means "give a material or discernible form to an abstract principle or concept". On that basis, the court found that the logo in this case was not embodied in the garments in the requisite sense.

The court observed that the section 77 defense could not logically stand alongside the section 44C defense, as the garments could not, at one time, both "embody" the logo and be conceptually distinct from it.

D. Brazil

1. Legal System

Brazil has a Federal Constitution, which establishes the principle of the right to defense and due process in all legal and administrative suits.

Binding sumulas rendered by the Federal Supreme Court may be applied as precedents to bind decisions held by all bodies of the judicial power.

International treaties hold the same hierarchical level as ordinary laws. In the event of a conflict, whichever came into force most recently will prevail. However, in the event of a conflict between a treaty and the Constitution or Supplementary Law, the last two should prevail, even if the treaty were ratified more recently. International human rights treaties hold constitutional standing.

2. Commencing Proceedings

Contracting parties in Brazil no longer have discretion to choose the law applicable to the agreement; rather, the law should result from what is set forth in Brazilian conflict of law statutes (namely, the Introductory Law to Brazilian Norms (LINDB)). That interpretation is of fundamental importance at the time agreements are being worded, especially if the judicial jurisdiction is chosen.

The procedure of civil and commercial disputes is governed by the Code of Civil Proceedings.

The Brazilian judicial procedure is mainly conducted in written form and the production of evidence is made before the singular judge, except in rare cases. As a general rule, in the ordinary procedure, the plaintiff and the defendant shall make the allegations of all facts and arguments, and present all documented evidence in the initial petition and reply, respectively.

3. Key Elements of Litigation

After the pleading phase, the parties enter the phase of evidence production where other types of evidence can be solicited (expert examination, inspection, bearing of witnesses and legal representatives, etc.). There is no discovery phase, but parties may be requested to produce documents or things in their possession in certain circumstances.

Upon conclusion of the production of evidence, the parties present their considerations about the produced evidence for the judgment of the case. Brazilian law allows the filing of appeals to all interim decisions throughout the proceedings. Interim appeals are decided after judgment is rendered, unless in exceptional circumstances, such as when the Court of Appeals finds a likelihood of irreparable harm and decides to stay the proceedings before the singular judge.

After judgment by the court, the appealing party can still file an appeal before the Superior Court of Justice, in the event the decision violates a prescription of federal law; or before the Federal Supreme Court, in the event the decision violates a prescription of the Federal Constitution.

Upon completion of the pre-judgment phase, where a declaratory, constitutive, condemnatory or ruling judgment is expected, the execution phase starts, with the search of assets that satisfy a creditor. Courts may electronically foreclose bank deposits, expediting enforcement against solvent debtors.

The new law around bankruptcy and reorganization encourages negotiation between debtor and creditors for the purpose of restructuring the company's business.

The judicial system is slow, and there is a crisis in execution mainly attributed to the intricate and complex current civil procedural system, as well as a large number of lawsuits creating a backlog in the system.

The Consumer Protection Code provides protection for product liability claims.

4. Costs

Judicial fees are provided by the competent courts as a percentage of the amount in dispute and capped to a moderate ceiling, although some other charges and fees may be applicable. For most civil cases, the Brazilian Civil Code provides an interest rate for delinquent payments of 1 percent per month, applicable from maturity in some cases and from the filing of suit in other circumstances, which may discourage protracted lawsuits.

5. Enforcement of Judgments

Judgments handed down from abroad will only be executed in Brazil after being confirmed before the Superior Court of Justice, which may deny the confirmation if the question is exclusively under Brazilian authority, or if public policy or the right to defense or due process (such as failure to serve notice) have been violated.

6. Arbitration

Arbitration is based on the UNCITRAL Model Law, as well as the ratification of important international treaties (such as those of the Panama and New York Conventions).

There are various mediation and arbitration centers in Brazil.

In the event of an incomplete arbitration clause, where it is not possible for a party to constitute the arbitral tribunal and institute the arbitration, the question shall be submitted to the judicial system, in order to obtain an arbitration agreement (more formal than an arbitration clause) for the beginning of the arbitration, which may greatly delay the final solution of the matter.

Brazilian law makes no distinction between national and international arbitration. For the purposes of recognition and enforcement, it makes a distinction between internal and foreign arbitration awards, depending on the place where the arbitration award is rendered.

The Arbitration Law recognizes party autonomy in the choice of law governing the arbitration, and permits the parties to choose the applicable law, including the law of foreign legal systems, equity, principles of the law and international trade rules, provided that they do not violate good customs and public order

Arbitral awards issued outside of Brazil need to be submitted to the Superior Court of Justice for recognition, allowing for enforcement through Federal Courts.

Arbitral awards will be acknowledged and executed in Brazil according to international treaties with efficacy in the internal legal system, or, if there is no treaty, according to the law.

E. Mexico

1. Legal System

Civil law, based on a Constitution that establishes the right of the people to be protected by the Federal Courts in the enjoyment and exercise of individual guarantees or constitutional rights.

Treaties have priority over ordinary laws of the Mexican Republic and must be applied by jurisdictional authorities, both at the state and federal levels.

Both the Supreme Court of Justice and the Circuit Courts issue judicial decisions that may later be recognized as binding jurisprudence or case law for all judicial authorities. Decisions become binding once there are five such decisions in the same terms or, if there are contradictory decisions, once the Supreme Court declares which of these shall prevail.

2. Commencing Proceedings

The Summary Commercial Proceeding, the Ordinary Commercial Proceeding and the Civil Codes of Federal or State Procedures, as applicable, regulate commercial disputes.

The Summary Commercial Proceeding is applied when the lawsuit is based on a complaint that entails execution. In this procedure, the plaintiff can indicate, at the time of the summons and the payment requirement, the property to be seized. The advantage of this proceeding is that the stages are shorter and the claimed debt is secured from the beginning of trial by means of the seizure of property.

The Ordinary Commercial Proceeding is applied when disputes do not have special procedures in commercial laws. Both proceedings are written where the judge must rely on matters alleged and proved by the parties, except for evidence to expedite the case.

Commercial proceedings are carried out in two instances, before the Federal District Courts or the First Instance Local Courts.

3. Costs

Normally, judgments allow the prevailing party to recover legal expenses that are regulated through an ancillary proceeding, which is regulated by a fee percentage structure. This procedure can vary from state to state.

4. Key Elements of Litigation

Judicial decisions issued by the Supreme Court of Justice and Circuit Court may later be recognized as binding jurisprudence or case law for all judicial authorities. Decisions will constitute case law when five similar decisions are executed.

If during a proceeding, an individual guarantee of one of the parties is violated, they have the right to file a Constitutional Complaint (*Amparo* Proceeding) to request the protection of the federal justice system and restitution of the individual guarantees that were violated.

In relation to product liability claims, the seller is obligated to correct any hidden defects found in the matter conveyed that hinder the buyer in using the product for its original purpose, or decrease its use in such a way that if the buyer had knowledge of the defect, it would not have purchased the product or would have paid a reduced fee.

Corporate criminal law covers violations to copyright and publication rights. Its purpose is to defend and/or represent persons against criminal actions in order to prosecute criminal acts performed by third parties against their properties.

Oral proceedings for civil and criminal matters have been implemented in some states. This reduces the delay in criminal proceedings.

If a debtor has defaulted on its payments, to two or more different creditors, of obligations that have been due for at least 30 days and that represent at least 35% of all his or her obligations, the debtor himself or herself, any creditor, the district attorney or a court in their capacity as creditors may file a claim at a federal court for an insolvency proceeding. General default on payment of obligations will also exist when the debtor does not have assets to pay at least 80% of his or her obligations due on the date of the filing of the claim.

Once the claim has been filed, the proceeding for insolvency begins. A visitor is appointed by the federal court to verify technically and physically, based on his or her impartial assessment, if a debtor fits the legal hypothesis to be declared insolvent. The claimant has to guarantee the visitor fees, in the amount of approximately MEX$65,500.00; otherwise, the case will be dismissed.

Reforms to the Constitution have been proposed and are expected to be implemented in 2016.

5. Enforcement of Judgments

The judgment of foreign courts can only be enforced in Mexico after obtaining a judgment from the First Instance Federal or Local Courts of the corresponding state. The court may deny enforcement of the judgment if any reasons to deny it under the Civil Code of Federal Procedures are present: e.g., if such a judgment is contrary to Mexican public policy or if process has not been served personally on the defendant.

6. Arbitration

Arbitration is valid in Mexico, and the alternative means of resolving conflicts are settlement, mediation and arbitration.

Commercial arbitration is applied by agreements between the parties. The Commercial Code or the Regulations of Arbitration by Private Courts are applied to commercial arbitration.

Institutional arbitration is carried out before a specialized arbitration institution, and independent arbitration, also known as *ad hoc*, involves no intervention by an arbitration center, because the parties are in charge of the administrative arrangements.

Arbitration may be in law or in equity.

The parties may choose the place of the arbitration.

Foreign arbitral awards are enforceable in Mexico. Enforcement may only be denied if any of the conditions established in article 1462 of the Commercial Code are present: e.g., the award is contrary to Mexican public policy, or parties had not been notified of the appointment of the arbitrators or were unable to effectively defend the arbitration.

Judges may not reanalyze the subject matter of the arbitration proceedings, but may only verify that the conditions of the arbitration agreement and of the Commercial Code have been met.

F. Japan

1. Legal System

Civil law, made up of the Constitution, Civil Code, Code of Civil Procedure, Criminal Code, the Code of Criminal Procedure and the Commercial Code. In addition, there are individual laws covering limited areas.

Case law also represents a significant part of Japanese law. Supreme Court judgments are one of the main sources of law in Japan.

Disputes in the luxury brand and fashion industry often involve intellectual property rights, such as trademark rights and copyright. In Japan, the Intellectual Property High Court (the IP High Court) was established in 2005, as a special, semi-autonomous division of the Tokyo High Court. The IP High Court has exclusive jurisdiction of lawsuits against appeal/trial decisions made by the Japan Patent Office (JPO), and appeals from district courts in civil cases dealing with IP rights, such as patent rights and utility model rights, design rights and trademark rights. Such cases will be heard by the IP High Court when they come under the jurisdiction of the Tokyo High Court.

2. Commencing Proceedings

A plaintiff initiates a claim by submitting a written complaint or petition to the District or Summary Court, depending on the value of the alleged claim. The court fee is paid at the time this document is submitted.

The fee is based on the value of the claim. The court reviews the claim and sends a copy to the named defendant, together with a notice to appear in court by a certain date. If the defendant does not appear for the first hearing, the court will not necessarily enter a default judgment, but may do so in the case of minor disputes, such as an application for a small claims order.

3. Key Elements of Litigation

Discovery Procedures

(a) Inquiries Between Parties (Toujisha Shoukai) is an interrogatory-like discovery device, which entitles a litigating party to furnish the opposing party with questionnaires concerning relevant factual issues. Under certain conditions, this is also available prior to filing a civil action. However, this measure is a voluntary procedure, which does not force each party to respond to the other party's inquiries.

(b) A Document Production Order (Bunsho Teishutsu Meirei) is an order of the court for production of documentary evidence held by the opposing or third party. However, a party seeking this order is required to specify the document for production, and internal documents prepared for the other party may not be produced. With such restrictions, this production method is not so extensive as U.S. discovery.

(c) A litigating party may request the judge to summon witnesses from the opposing or third party, in addition to offering its own witnesses, for testimony in the court.

(d) In the event that an unsuccessful party in an arbitration appeals to the court to set aside the arbitration award on the grounds stipulated in the local arbitration law, such as material procedural errors or fraud (perjury, etc.), everything contained in the arbitration case file may be produced before the judges.

Commercial litigation in Japan usually takes six to 12 months to complete in the first instance at the District Court level. Cases involving complex issues or many parties may take longer: 18 months or more.

The Civil Code provides that certain rights will expire if not pursued within 10 years from the date that the right arose. The party making the claim must make it within the prescribed period. However, special provisions can apply in particular cases.

A claim in tort must be brought within three years of the date that both the damage and the defendant were identified; however, the period cannot exceed 20 years from the date of the incident.

The remedies available:

i. for breach of contract, they include (i) the right to demand performance; (ii) recovery of damages; and (iii) rescission of the contract;
ii. for tort, compensation for the loss; and
iii. there are also interim remedies: (i) freezing assets; (ii) preserving property; (iii) provisional disposition.

Appeals can be made on questions of law to the appropriate court at any time prior to the expiry of the applicable appeals limitation period.

With respect to international jurisdiction, Japanese courts can sustain jurisdiction to adjudicate in a wider scope of cases, to the extent that this will not harm the interests of consumers and workers.

An agreement on jurisdiction is deemed to be effective if that agreement is related to a claim based on a certain legal relationship and made in writing.

4. Costs

Upon the conclusion of the proceedings, the court costs will be borne by the unsuccessful party. However, lawyers' fees are not recoverable except in certain limited cases (e.g., traffic accident cases).

5. Enforcement of Judgments

The methods of enforcement will differ according to whether the subject of performance is tangible property, and whether the subject is a monetary claim or not.

In the case of tangible property, the court bailiff may take possession of movable objects and the court may declare that immovable property be attached. In addition, claims against third parties can be attached. The asset may then be sold or transferred to the creditor.

Compulsory administration is appropriate when enforcement of payment of money is sought. For this method of enforcement, the court appoints an administrator to manage the property of the defendant and distributes any profits derived from that property to the creditor.

In substitute enforcement, the court orders a third party to do something at the cost of the defendant. This method is available for the enforcement of performance where the subject of performance is a non-monetary claim.

In indirect enforcement, the court may order a party to refrain from some action to do something (i.e., order an injunction), and may impose fines until the defendant complies. This method is available for the enforcement of non-monetary claims.

Generally, the enforcement of performance is not available where performance has become impossible, or where, in cases of improper performance, repairs or replacements cannot be made.

Recognition and Enforcement of Foreign Judgments

In order to enforce a foreign judgment in Japan, the plaintiff must seek a judgment for execution in a Japanese District Court. A foreign judgment will be considered valid in Japan if the following conditions are met:

i. the jurisdiction of the foreign court is sustainable under the international civil jurisdiction rules of Japanese law, an ordinance or a treaty;
ii. the defeated defendant has been properly served with a summons, or has appeared and presented the merits of the case;
iii. the contents of the judgment, and the procedure by which the judgment is rendered, are not contrary to the "public order" or "good morals" of Japan; and
iv. there is a reciprocal "guarantee".

6. Arbitration Law

Arbitration is not a popular method of dispute resolution, except in marine and construction-related disputes.

In international cases, the Japan Commercial Arbitration Association (JCAA) and International Chamber of Commerce (ICC) are the relevant arbitral associations in Japan, with the JCAA handling more cases than the ICC.

The role of the courts in arbitration is very limited. If the arbitration clause in an agreement is found to be valid, a court will generally refuse to accept litigation proceedings

An arbitration award is only effective upon the successful party obtaining an execution judgment from the court. This will be based on whether the award was made validly in accordance with the arbitration rules and Japanese law, and not on whether it was fair or reasonable.

7. Alternative Dispute Resolution

Mediation is recognized as a method of dispute resolution; however, it is rare for this type of dispute resolution to be adopted in international cases.

8. Interesting/Relevant Cases

a. Protection of Product Design

"PLEATS PLEASE" case: In 1999, a famous Japanese fashion designer, Issei Miyake, filed a lawsuit against a department store and manufacturer of women's clothing that sold clothing whose design was quite close to Issei Miyake's "PLEATS PLEASE" products. In Japan, industrial designs are not protected under copyright, and Issei Miyake had not obtained design registration for the "PLEATS PLEASE" products. Issei Miyake argued that the design of the "PLEATS PLEASE" products was a famous indication of his products, and that sales of products similar to Issei Miyake's products constituted "unfair competition" under the Unfair Competition Prevention Act. The court accepted Issei Miyake's arguments, and ordered cessation of sale of the defendant's products. This was a very early case that ruled fashion design can be protected under Japan's Unfair Competition Prevention Act if such a design has become well known in Japan.

In 2005, a manufacturer and seller of women's clothing products litigated against another seller of similar women's clothing, arguing that the defendant's product was an imitation of the plaintiff's product. The issue was that the product was of relatively simple design. The defendant argued that the features of the products were what products in such a category would normally have, and therefore the sales of the product should not constitute unfair competition. The Tokyo District Court dismissed the plaintiff's arguments, but the IP High Court reversed the decision and ordered cessation of sale of the defendant's products, ruling that it was an imitation of the plaintiff's product, which was prohibited under Japan's Unfair Competition Prevention Act.

HERMES Birkin bag case: HERMES, which obtained a 3D trademark registration for its Birkin bag, filed a lawsuit in 2013 against an operator of an online shop that imported and sold a product named the "ginger bag". The ginger bag looked, to some extent, similar to HERMES's Birkin bag, because printed on it were photographs of the front, side and back of the plaintiff's

Birkin bag. While, if he or she closely examined the defendant's bag, the consumer would understand that it was just a bag on which photographs of the HERMES bag were printed, the court ruled that the ginger bag infringed the plaintiff's 3D trademark registration.

b. Remake of Product

Cartier remake case: In 2005, the Tokyo District Court ruled that sale of a "remake" Cartier watch created by the defendant by adding diamonds to genuine Cartier watches was an infringement of Cartier's trademark rights. The court noted that even if the watch itself were a genuine product, creating a "remake" product harmed the trademark's function as a quality guarantee, because the diamonds attached by the defendant were not of good quality.

G. China

1. Legal System

China's legal system is based on the civil law system, with the Constitution being the principal law.

2. Commencing Proceedings

The relevant courts for claims arising in the luxury and fashion industry are the Supreme People's Court and the basic-level, intermediate and higher People's Courts.

Mandarin is the official language, and foreign nationals must secure the services of interpreters at their own expense, including translating the documents to be submitted to the courts.

Contract disputes will generally fall under the jurisdiction of the People's Court at the location where the defendant is domiciled or where the contract is performed. Where two or more People's Courts have jurisdiction, the plaintiff can institute his or her action in either of those People's Courts. The court that first lists the case will have jurisdiction.

The plaintiff institutes a suit by filing a complaint with the relevant court having jurisdiction over the matter. The defendant has the right to object to the jurisdiction of the court before which the action has been brought. The objection must be in writing and raised before the prescribed time for filing the reply is due. The court will examine the grounds of the objection and decide on the jurisdictional issue before investigating the substantive issues. If the court finds it has jurisdiction, it will dismiss the objection, and if it finds it has no jurisdiction, it will transfer the case to another court that has jurisdiction over the matter. However, if the matter does not fall within the jurisdiction of the People's Republic of China (PRC) courts – e.g., a dispute that is subject to a valid arbitration agreement – the court will dismiss the case. The trial will be suspended until the jurisdiction issue is settled.

The complaint is a statement of claim containing a brief description of the facts of the case, the causes of action, particulars of the legal claims, and the legal and factual grounds in support of the claims. It must state the evidence relied on, the source of evidence and the names of witnesses for the plaintiff. The plaintiff should specify the amount of the monetary claim, as this determines the amount of court fees to be paid and the level of court that has jurisdiction over the case.

The defendant must file its response within 15 days of receipt, unless the defendant has no domicile in China, in which case the time limit is 30 days. These time limits can be extended with the approval of the court. If the defendant submits an objection to jurisdiction, a new reply period will be granted by the court after the jurisdiction issue is settled.

3. Key Elements of Litigation

The court is responsible for the service of process in civil actions. Within five days of the acceptance of a case, the court must effect service. There are several methods to effect service of process, including direct service, deemed service, service through entrustment, service by mail, forwarding service, service by public notice and service by diplomatic channels (in a foreign-related action).

Direct service can be effected by delivering the documents to any agent authorized by the foreign company to receive process in China, its representative office in China, or its branch or business agent in China if it is authorized by the foreign company to accept service.

Otherwise, service is usually undertaken through diplomatic channels, or in accordance with an international treaty concluded between or acceded to by the state of the person to be served and China (please note that China has acceded to the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents in Civil and Commercial Matters). Service through this method may take several months. In a recent case, service through diplomatic channels took around nine months.

The types of service referred to in the first two paragraphs of this section are the most common methods used by the courts to serve the civil complaint and case acceptance notice upon a foreign company. In some limited cases, the courts may effect service by a public announcement in a national newspaper.

In addition, PRC law permits court documents (excluding judgments, orders and mediation letters) to be served electronically, including by email and fax, as long as the party to be served agrees beforehand. In practice, the courts do not usually use this method to serve the civil complaint and case acceptance notice on a foreign company.

Unlike in the common law jurisdiction, there is no discovery process in China. Each party may decide to only submit favourable evidence and withhold adverse evidence, as there is no obligation to disclose all documents.

Generally, the party asserting an allegation bears the burden of proof, save in certain kinds of cases.

The concept of burden of proof was further defined by a Supreme People's Court's interpretation in April 2002. Under this interpretation, the burden of proof is reversed in certain kinds of cases. For example, in patent infringement cases, the burden of proof rests with the defendant to prove that the infringing product was produced in a different way than the product produced by the patent holder. The interpretation provides for a more nuanced system of burden of proof. Parties may now be threatened with "*unfavorable consequences*" if they fail to provide the opposite party with evidence that has been requested. Under the interpretation, a party who withholds evidence risks the court drawing a negative inference from this uncooperative behavior.

4. Costs

Several different types of costs may be payable by litigants. The most important of these is the case acceptance fee, which is levied on a sliding scale based on the value of the claim (the aggregate amount of damages sought by the plaintiff). The general rule for costs is that the losing party will pay the case acceptance fee. If both parties are held liable, the case acceptance fee may be shared.

In normal circumstances, the costs incurred by the parties in engaging counsel to conduct the case on their behalf are not recoverable, except where the relevant legislation or regulations applicable to the claim in question specify otherwise.

5. Enforcement of Judgments

A judgment creditor has up to two years to apply for enforcement of the judgment.

The original court of first instance has the responsibility to enforce the judgments it has issued.

Failure to perform within the stipulated time limit by the party against whom judgment has been made leads to measures for compulsory execution.

If the person or property against which execution is enforced is located in an area beyond the territorial jurisdiction of the court, a local court in that area that is of the same level as the court of first instance may be entrusted to enforce the judgment. The entrusted court must commence execution within 15 days after receipt of the written request of another court.

A court may grant a stay of execution of the judgment where the prevailing party seeks a postponement of the execution; a non-party presents a reasonable objection to the execution; one of the parties ceases to exist or dies, and the other parties must await the appointment of a successor; or in other circumstances that the court deems it appropriate to call for a stay.

A court may also terminate the execution of the judgment. Such a ruling may ensue when the prevailing party withdraws the application for execution; a higher court cancels the legal document upon which the execution is based; the losing party dies and leaves no estate or persons to assume obligations; the losing party, being a citizen, is unable to make repayment, due to poor financial circumstances; or in other situations the court deems appropriate. A ruling by a court to stay or terminate execution will take effect immediately upon being served on the parties concerned.

The continuance of an enforcement proceeding often depends on what assets of the respondent can be located by the applicant or the court. Cash, real estate and shares of a listed company are relatively easy to realize. However, a shareholding in a private company presents more difficulties. If there is no buyer and the applicant does not agree to take the shareholding, the shareholding will be returned to the respondent. The applicant then has to locate other assets belonging to the respondent. In such a case, the enforcement proceeding will be prolonged.

6. Recognition and Enforcement of Foreign Court Judgments

PRC law provides for the enforcement of foreign court judgments in accordance with international treaties concluded or acceded to by China or the principle of reciprocity, provided they do not violate basic principles of Chinese law, state sovereignty and security or public interest. Reciprocity is interpreted as willingness by a foreign court to enforce a judgment issued by a Chinese People's Court. This may be difficult to establish.

Hong Kong and the PRC have entered into an arrangement for the mutual recognition and enforcement of final judgments in civil and commercial matters (excluding employment, family and contracts for personal – not business – arrangements) (the Arrangement). Final judgments made in Hong Kong and the PRC are therefore potentially enforceable.

Under the Arrangement, only money judgments will be recognized and enforceable. A number of preconditions have to be met, including that the contract to which the money judgment relates must contain a submission to the exclusive jurisdiction of one court, either in the PRC or Hong Kong, and the contract must have been entered into after the Arrangement came into effect, on 1 August 2008. Non-monetary judgments, such as injunctions, do not fall within the mutual recognition regime. Judgments that do not fall within the Arrangement will have to be enforced at common law; this usually means relitigating the issue in the place where enforcement is intended.

7. Arbitration

Arbitration is a popular alternative to litigation, and China has a well-established structure for resolution of disputes by arbitration. It can be divided into domestic and foreign or foreign-related arbitration.

Arbitration in China is conducted by arbitration commissions located in various provincial capitals and certain other cities. The China International Economic and Trade Arbitration Commission (CIETAC) is China's principal international arbitration body, and deals with domestic and international commercial disputes.

Foreign lawyers are permitted to be engaged as counsel for the parties in arbitration but are not allowed to express specific opinions or conclusions on Chinese law.

Under PRC law, an arbitration agreement may take the form of a clause in a contract or separate agreement in writing that must contain an expression of the parties' intent to submit to arbitration, the arbitration institution, describe the matters to be referred to arbitration and that it has been entered into free of coercion. China does not recognize domestic *ad hoc* arbitration.

The court may intervene as necessary to preserve evidence for the purpose of the proceedings, or to maintain the status quo of the parties, or to prevent the other party from removing assets from the jurisdiction that may be used for later enforcement.

An arbitration award is final and binding on the parties, and may be set aside or refused enforcement in limited circumstances, where: (i) the parties did not include an arbitration clause in their contract or conclude a written agreement; (ii) the party against whom enforcement is sought was not asked to appoint an arbitrator or take part in arbitration proceedings, or was unable to present its case for reasons for which it was not responsible; (iii) the arbitration tribunal or procedure did not conform to the applicable rules; (iv) the matters decided in the award exceeded the scope of the agreement or arbitration institution; or (v) the award violates the public interest.

The Supreme People's Court has recognized the validity of an award issued by a foreign arbitration institution with the arbitration seat in China. However, the court has not specified whether such an award is a domestic or foreign award and whether the courts can intervene to grant interim relief.

H. Hong Kong

1. Legal System

The Basic Law gives validity to all laws enforced in Hong Kong and authority to the judiciary and the government. It also defines the relationship between the PRC and the Hong Kong government.

The Hong Kong courts continue to apply common law principles in accordance with the regime established under the Basic Law.

2. Commencing Proceedings

The courts have jurisdiction over a dispute where the person or thing (which is the subject of the dispute) is present in Hong Kong. Therefore, when the defendant can be served with proceedings in Hong Kong, the court will have jurisdiction even if the case otherwise has little connection with Hong Kong.

Where a prospective defendant is not in Hong Kong, the leave of the court of first instance is needed to serve the proceedings out of the jurisdiction. The grant of leave is discretionary, and will be granted only in specified cases under the Rules of the High Court. In essence, the dispute must have a sufficient connection with Hong Kong for the court to grant leave to serve out of the jurisdiction.

The plaintiff begins its action by issuing a writ of summons or originating a summons outlining the parties and a brief statement of the claim. This must be served on the defendant within 12 months, although this time frame can be extended on application to the court.

A defendant must file a notice of intention to defend within 14 days of service. If it is not filed within this time frame, a judgment of default may be entered.

3. Key Elements of Litigation

It is the legal duty of each party and its solicitor to make full disclosure of those documents that are or have been in its possession or control and are relevant to the issues in the action. This normally takes place after completion of exchange of pleadings, although pre-action discovery is possible in certain circumstances.

The courts' power to allow pre-action discovery applies to all types of cases. The applicant must show that it and the respondent are likely to be parties to anticipated proceedings, and that the documents sought are directly relevant to an issue arising out of the claim or are necessary for dealing with the claim fairly or for saving costs.

Discovery is an important part of the litigation procedure, and its extent and expense in commercial actions can be considerable.

Parties can seek discovery against third parties where the third party is likely to have or have had in its possession any documents that are relevant to an issue arising out of the claim. The test for relevance is slightly wider than for pre-action discovery.

Some classes of documents are privileged and exempt from production and inspection. These are as follows:

(a) communication with legal advisors for the purpose of obtaining legal advice; and
(b) documents incriminating or exposing a party to a penalty under Hong Kong law.

Confidential documents not otherwise privileged must be disclosed and produced for inspection, but the court may order a controlled method of disclosure to protect confidentiality.

Oral discovery of any person before trial, in the form of a deposition, may also be ordered where it appears necessary to the court for the purposes of justice (e.g., where a witness is too old to attend court).

The court can make orders limiting discovery that the parties would otherwise be required to make under the discovery rules and can direct the manner in which the discovery is to be made.

The court will consider authority from other common-law jurisdictions, including England, to be persuasive, although it is not binding. The court is developing its own jurisprudence having regard to the legislative background and other circumstances affecting Hong Kong.

Defendants facing a monetary claim may make a sanctioned payment of a sum of money into court as an offer to settle. Parties wishing to settle a non-monetary claim may make a sanctioned offer in writing.

If a sanctioned offer/payment is accepted within 28 days, the plaintiff will be entitled to its costs up to the date of acceptance. All further proceedings will be automatically stayed.

With limited exceptions, an appeal is possible at every stage of litigation.

4. Costs

A foreign plaintiff without assets in Hong Kong, or an insolvent Hong Kong company, may be required to give security for the proportion of the defendant's costs that it may have to pay if it were unsuccessful in the action. There is no requirement for a foreign defendant to give security unless it goes beyond defending the proceeding and makes a counterclaim arising out of different matters against the plaintiff, or the foreign defendant is the appellant in an appeal.

The unsuccessful party in proceedings is almost invariably ordered to pay the costs of the successful party. The court has a discretion in ordering reimbursement of costs and the amount of such costs. The successful party rarely obtains full reimbursement for all its costs – the proportion is generally about two-thirds of the actual costs paid.

5. Enforcement of Judgments

A judgment takes effect from the time it is pronounced. Interest runs on the amount of the judgment from the date of judgment at the statutory rate applicable from time to time. Pre-judgment interest is calculated as part of the judgment sum.

The principal methods of enforcement of judgment debts or the carrying out of orders of the court are:

i. issue of a writ of execution;
ii. presentation of a petition to wind up a defendant company or to declare bankrupt an individual defendant;
iii. examination of the judgment debtor (or where it is a company, one of its officers) before a master by oral cross-examination on oath about debts owing to him or her and what other property or means he or she has of satisfying the judgment;

iv. debts due to the defendant may be ordered to be paid directly to the plaintiff to satisfy the judgment;
v. a charge in favor of the plaintiff is imposed on an interest in land or securities owned by the defendant;
vi. appointment of a receiver over the defendant's interest; and
vii. proceedings for contempt, where a person does not comply with the terms of the judgment. The person may be fined, or a writ of sequestration may be issued against their property, or if there have been repeated failures to carry out undertakings, they may be committed to prison.

Recognition and Enforcement of Foreign Judgments

A Hong Kong judgment can be registered and enforced in any country where there is a reciprocal agreement for enforcement of judgments.

If a foreign judgment for the payment of a sum of money (a money judgment) is obtained in a country designated under the Foreign Judgments (Reciprocal Enforcement) Ordinance, then an application can be made to the Hong Kong court to register that foreign judgment. This is decided on a case-by-case basis. Otherwise, the creditor must bring fresh proceedings on the foreign judgment in Hong Kong.

A court will recognize and enforce a judgment obtained abroad, and without going into the underlying merits of the claim, if certain conditions are satisfied.[12]

Hong Kong and the PRC also have an arrangement for the mutual enforcement of money judgments. Certain criteria will need to be satisfied, including a condition that the dispute arise out of a commercial contract selecting either a Hong Kong or PRC court as the exclusive court for resolving disputes under that contract.

6. Arbitration

Hong Kong's Arbitration Ordinance adopts the UNCITRAL Model Law and unifies the previously separate domestic and international regimes into a single regime.

An arbitrator is allowed to act as a mediator after arbitral proceedings have begun, subject to the parties' consent. Once appointed, the arbitration will be stayed and the mediator will attempt to help parties to try to settle a matter.

Court proceedings relating to arbitration are not to be heard in open court unless the court directs otherwise.

Arbitral awards are enforceable in the same manner as court judgments, but only with leave of the court.

ICC arbitrations can be heard in Hong Kong. In addition, arbitrations can be brought at the CIETAC Hong Kong Arbitration Centre. This enhances Hong Kong's position as a center for international arbitration.

[12] (i) the foreign court had jurisdiction over the defendant according to Hong Kong rules; (ii) the foreign judgment was not obtained by fraud; (iii) the foreign judgment was not contrary to Hong Kong rules of public policy or notions of natural justice; (iv) the foreign judgment was for a debt or a definite sum of money; and (v) the foreign judgment was final and conclusive.

7. Alternative Dispute Resolution

Mediation is now very active and quite successful in Hong Kong, due to the civil justice reforms that require courts to encourage parties to use ADR procedures.

Parties are required to stipulate their willingness to attempt mediation with a view to settling proceedings. The courts can also impose an adverse costs order where there has been an unreasonable refusal to mediate.

There are also a number of non-profit organizations established in Hong Kong to assist with disputes involving smaller amounts.

I. France

1. Legal System

Civil law, made up of the Constitution, treaties, conventions, statutes and EU law.

The Constitution takes precedence over all other statutes.

Statutes are enacted by Parliament. The executive has the power to issue regulations for limited purposes.

Judicial decisions are also important, because they interpret the aforementioned legal sources. However, court decisions play a comparatively minor role. A vast majority of French law is codified.

2. Commencing Proceedings

Civil court proceedings are governed by the Code of Civil Procedure.

An action may be initiated by the submission of a joint application or, more usually, by a writ of summons, which contains details of the parties, the relevant facts, the legal arguments on which the claimant intends to rely and the relief sought. The writ of summons must be filed with the clerk of the relevant court (which has jurisdiction) prior to the first hearing. If a writ of summons is filed with a court that lacks jurisdiction, this will suspend any applicable statute of limitations.

The writ of summons must also be served on the defendant, who will be given sufficient time to prepare its defense prior to the first hearing (generally, at least 15 days before the first hearing). A bailiff serves the writ by personally delivering it to the defendant's domicile or business premises.

The defendant gives notice of its intention to defend itself (generally 15 days from service) or by attending the first hearing.

Once the defendant has given notice of its intention to defend itself, a preliminary hearing takes place, in which the President of the Court will schedule a date for commencement of the trial. Nevertheless, the defendant cannot defend itself before the Civil Court and the Court of Appeal.

3. Key Elements of Litigation

French civil procedure is based almost exclusively on written evidence.

Each party can produce the relevant documents that are in its possession and submit them to the court, together with the written pleadings, explaining the facts and the legal arguments upon which it relies. The parties have to submit to the court any document they consider necessary to prove their claim, but there is no obligation to disclose to the court or any other party all of the documents relating to the case.

If documentary evidence is not provided voluntarily, the judge may be requested to order disclosure. The judge may determine the method by which disclosure should be made and a time limit for compliance. Generally, this will be by exchanging lists of documents and copies of those documents.

The parties are responsible for proving the facts necessary for the success of their claims. The judge will not base his or her decision upon facts that are not in issue. However, he or she can invite the parties to give factual explanations that he or she considers necessary for the resolution of the dispute. He or she also has the power to order investigative measures. For instance, judges frequently appoint an independent expert to investigate technical matters. The work of the expert is governed by the Code of Civil Procedure and is carried out in the presence of the parties. Judges are not bound by the findings of the expert, although they often follow the expert's conclusions.

Judges may also order the disclosure of a document in the possession of a third party, or request the oral testimony of third parties.

Once a trial has started, it generally takes about 12 months from the start of the action to the issuance of a decision (depending on the workload of the court).

The trial is open to the public, except where the law requires otherwise or where the judge decides that it should take place in chambers: e.g., if publicity would result in the violation of privacy.

The judge may rule at the end of the hearing, but judgment will usually be given at a later date (normally, within a few weeks). The judgment issued by the court sets out the claims, the legal arguments of each party and the grounds for the court's decision.

Remedies include:

(a) damages;
(b) specific performance; and
(c) injunctions and declarations.

In order to protect the claimant against the defendant's insolvency, attachment may be ordered on all movable goods that belong to the defendant, thus restricting the defendant's ability to sell the assets.

In urgent cases, and if the claim is not, after a rough analysis, seriously questionable and if there is a risk regarding the recovery of the debt, a claimant may file an application without notice to the defendant, requesting that the court issue a temporary order to seize assets belonging to the debtor, in order to guarantee the payment of his or her debt; an injunction restraining the defendant from repeating or continuing any wrongful act; or an order stopping or preventing the damage, transfer, sale, removal or disposal of any property in dispute until the case is finally determined or until the court orders otherwise. The court will grant a temporary injunction where, if such an order were not granted, there would be a risk of the claimant suffering irreparable damage.

It is possible to obtain a court order requiring payment without notice to the defendant. This procedure is only available for certain kinds of debts and only if the sum can be determined precisely by means of supporting documents. Any objection to the order must be filed within one month from the date of notification by the bailiff. If no objection is filed within this period, the order becomes enforceable, and has the force of a final judgment.

If the order is refused, or if the debtor raises an objection (which may relate to the existence of the debt, the amount or any other element of the claim), the action will proceed as a contested action.

There is one level of appeal, before the courts of appeal. A decision of a court of appeal, as well as final and binding decisions from first instance courts that are subject to appeal, may be challenged before the Supreme Court in civil matters for improper application of the law.

4. Costs

In limited circumstances, a party may be required to deposit funds as security for the costs of the case. Such orders are rare and will generally only be made in respect of part of the relevant costs (e.g., where one of the parties requests that the court appoint an expert). It will normally be the responsibility of that party to secure the expert's costs, by making an advance payment to the clerk of the court.

With respect to recovery of costs, there is a distinction between costs and compulsory expenses. The party that loses the case is normally ordered to pay the costs of the winning party, unless the judge requires another party to pay all or part of them. These costs could include administrative costs, the charges, taxes and fees levied by court secretariats or the fiscal administration, compensation of witnesses, remuneration of experts and similar costs. In most circumstances, the judge orders that the losing party pay part of the compulsory expenses. Compulsory expenses mainly include legal and translation fees. In practice, such orders normally cover only part of the legal fees actually incurred, the judge deciding at his or her sole discretion the amount to be paid by the losing party. The fact that the lawyer may be instructed on a conditional or contingency fee arrangement has no impact on the costs recoverable because the court will not be aware of any arrangement existing between the lawyer and his or her client.

5. Enforcement of Judgments

Generally, only a final and binding court decision is enforceable. But decisions from a court of first instance can be enforced, even if an appeal is pending, provided that the first instance court declared it enforceable.

The defendant is expected to voluntarily comply with a final and binding decision. If the defendant refuses to pay, the claimant can enforce the judgment in the following ways:

i. request that a person who owes money to the defendant pay the claimant directly;
ii. attach movable physical goods owned by the debtor (whether or not in his or her possession) to keep them for himself or herself or have them sold and is entitled to payment from the proceeds of the sale, without an additional order from the judge;

iii. request an order for the sale of real property owned by the debtor in order to be paid from the proceeds of the sale; or
iv. if the defendant appeals and if he or she resists the enforcement attempts (in spite of the enforcement order by the first court) the plaintiff may ask the Court of Appeal to order a stay of the appeal until the payment of the debt.

A foreign court's decision will have effect in France only if a French court recognizes and enforces the judgment. There are three types of enforcement procedure:

i. Judgments where there is no bilateral or multilateral treaty between France and country where the initial decision was rendered. Courts in the U.S. are subject to this enforcement. If enforcement is granted, the judgment can be enforced in the same way as a French judgment.
ii. Where there is a bilateral treaty for the enforcement of foreign judgments, the treaty will usually provide for enforcement after obtaining an order of the court and provided conditions provided by the treaty are fulfilled.
iii. Enforcement of judgments from European Community (EC) countries.

6. Arbitration

Parties to a contract may choose to arbitrate before or after a dispute has arisen. The Civil Code determines the extent to which parties are able to turn to arbitration, and the Code of Civil Procedure differentiates domestic arbitration from international arbitration and sets out the procedural rules governing both types of arbitration.

An arbitration is deemed international when it involves the interests of international trade.

The arbitration agreement may directly appoint arbitrators and determine, either directly or by reference to specific arbitration rules, the procedure to be followed in the arbitration proceedings.

Courts will not interfere in arbitration proceedings – however, they may intervene to assist in four cases:

i. the place of arbitration is France;
ii. the parties have chosen to submit the arbitration proceedings to French procedural law;
iii. in order to prevent a denial of justice; and
iv. the parties have specifically given French courts jurisdiction over disputes pertaining to the arbitration proceedings.

A party may initiate an action before French courts despite the existence of an arbitration clause, in order to request temporary or protective measures in urgent cases and provided the arbitral tribunal has not yet been constituted.

French courts may also assist in the enforcement of the arbitration award in the event the unsuccessful party does not comply voluntarily.

Aside from those prohibitions set out in the Code of Civil Procedure, there are no prohibitions on parties conducting *ad hoc* arbitrations in France or on parties turning to international arbitration institutions.

In domestic arbitrations, an arbitral award is binding on the parties once it is rendered, but it may only be enforced after an enforcement order is issued by the tribunal de grande instance of the place where the award was rendered. Provisional enforcement orders are also available

An arbitration award shall be declared enforceable in France by the enforcement judge if such enforcement is not obviously contrary to international public policy.

France is a party to a number of bilateral and multilateral treaties on recognition and enforcement of foreign arbitration awards, including the New York Convention of 1958, the Geneva Convention of 1927, the European Convention of Geneva of 1961 and the Washington Convention of 1966. These Conventions provide for mutual recognition and enforcement of arbitral awards in countries that are parties to them.

An award rendered in a domestic arbitration may not be appealed unless the parties have expressly agreed otherwise.

Awards rendered in France for an international arbitration cannot be appealed – however, the parties can attempt to have the award set aside by domestic courts on the following grounds:

i. the arbitral tribunal wrongly upheld or declined jurisdiction;
ii. the arbitral tribunal was not properly constituted;
iii. the arbitral tribunal ruled without complying with the mandate conferred upon it;
iv. due process was violated;
v. recognition or enforcement of the award is contrary to international public policy, in international arbitration, and domestic public policy, in domestic arbitration;
vi. the award failed to state the reasons upon which it is based, the date on which it was made, the names or signatures of the arbitrator(s) having made the award; or
vii. where the award was not made by majority decision (only for domestic arbitration).

7. Alternative Dispute Resolution

In an attempt to resolve the problem of French courts' excessive workload, there have been efforts in recent years to institutionalize mediation and conciliation proceedings in the French legal system.

Conciliation is compulsory in certain cases, such as in labor law, where conciliation is the first phase of the proceedings. ADR is, like arbitration, consensual, and is a way to achieve resolution of a dispute more speedily and with greater confidentiality than formal court proceedings.

J. Germany

1. Legal System

Civil law jurisdiction, made up of the Constitution, the Civil Code, the Code of Civil Procedure, the Commercial Code, the Criminal Code and the Code of Criminal Procedure; Acts covering areas such as intellectual property, corporations or bankruptcy.

The legal concept of precedent is unknown to German law. Previous decisions of higher courts do not have a general binding effect on lower courts; however, in practice, lower courts generally do follow case law developed in higher courts.

2. Commencing Proceedings

A claimant commences legal proceedings by filing a statement of claim (which outlines the relevant facts and applies for a specific remedy) with the court of first instance having jurisdiction. If the action is a claim for payment (e.g., purchase price, damages), the amount has to be specified. In all claims, the claimant must identify the evidence on which it intends to rely, including providing the full names and addresses of witnesses.

When filing the statement of claim, the claimant has to pay a court fee for the first instance proceedings. The amount of the court fee depends on the value of the matter in dispute. Once the claimant has paid the court fee, the court serves a copy of the statement of claim on the defendant.

When the statement of claim is served on the defendant, the judge usually sets a deadline for the defendant to submit its statement of defense. At this stage, the judge may also schedule a date for an initial court hearing. If a defendant fails to serve a defense within the deadline set by the court, or if a party does not appear at any scheduled hearing, the other party may apply for a default judgment.

3. Key Elements of Litigation

The court must try to assist the parties to reach an amicable settlement throughout the proceedings. A conciliation hearing takes place prior to the main hearing in every civil case, unless an independent conciliation authority has already unsuccessfully attempted to settle the dispute, or if a conciliation attempt is clearly pointless. In complex cases, judges often put pressure on the parties to conclude a settlement. As a result, many cases are settled in court.

There will be at least one court hearing, sometimes more, depending on the complexity of the case. The emphasis of German court proceedings is on written statements in which the lawyers are expected to explain all aspects of the case. Only the critical and controversial facts that the court considers relevant are discussed at hearings.

Generally speaking, the plaintiff bears the burden of proof for facts that support its position. If the plaintiff fails to prove facts for which it bears the burden of proof and are contested by the other party, the courts may decide in favour of the other party.

The German Code of Civil Procedure does not specifically address disclosure, but courts have the power to request a party or a third party to produce specific documents relating to certain points raised by either party, regardless of the burden of proof. The courts may make such a request if the party who relies on these documents does not have possession of them or if production of such documents would further the court's understanding of the case. However, orders of this kind are rare.

In civil proceedings, evidence usually consists of documentary evidence, witness testimonies and expert opinions. Physical inspection of property or assets and, in certain circumstances, examination of a party are also permissible evidence. Parties to court proceedings (e.g., managing directors and members of a board of directors) cannot normally be heard as witnesses on issues for which that party bears the burden of proof. The evidence is taken by the judge, not by the parties. There is no pre-trial discovery or deposition and no U.S.-style cross-examination of witnesses.

If a claim can be based on documentary evidence alone (e.g., a cheque or a bill of exchange), a claimant may choose documentary proceedings. In these proceedings, no witness or expert evidence is admitted and a judgment that is enforceable without security can be obtained relatively easily and quickly. A defendant may request that a judgment reached in documentary proceedings be reviewed in subsequent proceedings where all means of evidence are admissible.

The duration of legal proceedings depends on the individual case and the approach taken by the judge. As a guide, first and second instance proceedings normally each take between six months and one year, while proceedings at the Federal Supreme Court normally take 12 to eighteen months. In complex cases, it is not unusual for each stage in the proceedings to take more than one year.

A claim for payment of money may be pursued through summary proceedings. These should generally only be considered if the debtor is not expected to defend the claim or if the running of a limitation period needs to be suspended as a matter of urgency; otherwise, they may cause a delay of one to two months.

The German Code of Civil Procedure recognizes different types of "appeal": namely, a first appeal, a second-tier further appeal on questions of law, and an objection against a default judgment. Furthermore, an "appeal" is possible against preliminary injunctions and attachment orders.

There are several methods of enforcement for monetary claims, as follows:

i. assets can be seized;
ii. a court order requiring a third-party debtor to pay to it any sums the third-party debtor owes the judgment debtor;
iii. a charge against real property, effecting an execution sale;
iv. delivery up; and
v. specific performance.

4. Costs

Litigation costs consist of court fees and court expenses (e.g., for witnesses or experts) as well as lawyers' fees.

The losing party has to bear all costs of the proceedings, including the other party's legal fees. If a party is only successful in part, the costs will be split proportionately between the parties.

The amount of legal fees that can be recovered from the losing party is limited by statute, and depends both on the value of the claim and the different stages involved in resolving the dispute.

5. Enforcement of Judgments

Where EC regulations or multilateral or bilateral conventions do not apply, recognition and enforcement of foreign judgments is governed by the Code of Civil Procedure.

Foreign judgments are automatically recognized by German courts, unless one of the following provisos applies:

i. the foreign court did not have jurisdiction according to German law on international jurisdiction;
ii. the defendant did not enter an appearance and is able to show that it did not have an opportunity to defend itself due to wrongful or late service of the documents initiating the action;

iii. the judgment is inconsistent with a German judgment or an earlier recognisable foreign judgment, or the underlying foreign proceedings are incompatible with earlier German proceedings;
iv. recognition of the judgment would be contrary to German public policy (e.g., the judgment conflicts with basic rights under the Constitution or awards punitive damages); or
v. reciprocity is not guaranteed (e.g., an equivalent German judgment would not be recognized in the relevant foreign country).

Recognized foreign judgments are not automatically enforceable in Germany; they need to be declared enforceable by judgment of a German court. Such judgment will only be granted if the foreign judgment is recognisable and final (e.g., it has become non-appealable under the applicable foreign law).

The EU Regulation and certain conventions provide that it is not necessary to obtain a judgment of a German court declaring a foreign judgment enforceable. In such cases, in order for a foreign judgment to be enforceable in Germany, the only requirement is for an execution clause, which can be obtained from the court in relatively easy, fast and inexpensive proceedings.

6. Arbitration

Germany has adopted into domestic legislation the UNCITRAL Model Law on International Commercial Arbitration. It was the express goal of the German legislator to increase the attractiveness of Germany as a forum for international arbitration.

The role of German courts in arbitration is limited. If a claim is filed in a state court and the court determines that the dispute is subject to an arbitration agreement, the court must dismiss the claim. However, until an arbitral tribunal is constituted, any party may file a motion with the Court of Appeal to establish by declaratory judgment whether or not the arbitration clause or arbitration agreement is valid.

After commencement of arbitration proceedings, the arbitral tribunal has jurisdiction over the question of whether the arbitration clause or agreement is valid. If one of the parties pleads lack of jurisdiction of the arbitrator(s), the arbitral tribunal must rule on this issue. Each party is entitled, however, to apply to the Court of Appeal for a review of this ruling.

The German Institution of Arbitration (Deutsche Institution für Schiedsgerichtsbarkeit (DIS)) is a non-profit registered association that promotes arbitration and provides a uniform service for all arbitration-related matters across Germany. The DIS Arbitration Rules are suited to both domestic and international arbitration proceedings. Application of the DIS Rules is not limited to arbitration proceedings conducted in Germany.

Alternatively, the parties may conduct their arbitration under the auspices of an international arbitration institution, such as the ICC. *Ad hoc* arbitrations are frequently used in Germany to settle disputes.

A German arbitral award can be enforced if it has been declared enforceable by the competent Court of Appeal. The Court of Appeal will only refuse to declare an arbitral award enforceable if:

i. the arbitration agreement is invalid;
ii. a party was not given proper notice of the appointment of an arbitrator or of the arbitration proceedings;

iii. the award deals with a dispute not contemplated by or not falling within the terms on which the dispute was submitted to arbitration, or contains a decision on matters beyond the scope of these terms;
iv. the arbitral procedure or the composition of the arbitral tribunal contravened the Code of Civil Procedure or an admissible agreement of the parties, and this contravention affected the award;
v. the subject matter of the dispute was not capable of resolution by arbitration under German law; or
vi. recognition or enforcement of the award would lead to a result that would conflict with public policy.

Defenses based on substantive law are not admissible in proceedings to declare an arbitral award enforceable.

It is generally accepted under German law that a foreign arbitral award will be recognized and enforced in Germany in accordance with the provisions of the New York Convention, regardless of whether or not the country in which the award was made is a party to this Convention.

An arbitral award is final and, unless the parties have agreed on second instance arbitration, proceedings cannot be appealed. The Court of Appeal can, however, set aside an arbitral award on any of the grounds mentioned in the section on domestic arbitral awards above.

7. Alternative Dispute Resolution

There are no statutory provisions governing ADR in Germany. Based upon the general legal principle of freedom of contract, any rules relating to a process of ADR that the parties have agreed upon will be binding on the parties. In the past, ADR procedures were rarely adopted, but the interest in ADR methods has increased recently.

K. Italy

1. Legal System

Civil law, made up of the Constitution, treaties, national and regional legislation, and EU law.

Civil proceedings are governed by the Code of Civil Procedure, which came into force in 1942 and has undergone several reforms in the intervening years.

2. Commencing Proceedings

Before commencing proceedings in relation to civil and commercial disputes, parties enter into a mandatory mediation procedure that is a precondition for proceeding with a court action for disputes involving: rights in rem; assets division; leases; loans; going business leases; insurance and banking contracts and other financial contracts; tort actions on defamatory statements in the media; and medical malpractice.

The mediator may submit a written proposal of settlement of the dispute. If the mediation process is successful, the mediator drafts the settlement agreement, which will be validated by the

President of the Court in which the mediation body is registered, to verify its compliance with the law. Upon validation, the settlement agreement will become fully enforceable.

If the mediation procedure fails and the judgment of the court corresponds with the judgment of the mediator, the winning party that declined the mediator's proposal will not be allowed recovery of its costs and attorney fees. Further, the judge is entitled to draw inferences against a party that refused to participate in the mediation without just cause.

Subject to the completion of the above-mentioned mandatory mediation procedure, civil proceedings are generally commenced with service of a writ of summons by the claimant on the defendant. The writ of summons is drafted and signed by legal counsel with authority (by power of attorney) to sign on behalf of his or her client.

The writ of summons must contain all the elements necessary to identify the claim and causes of action. Between service of the writ of summons and the date given for the first hearing, the defendant has at least 90 days (or 150 days in the case of a defendant residing abroad) to prepare its defense.

The writ of summons must be filed at the court after service, in order for the case to be entered on the court register and assigned to a specific judge.

The defense must be filed with the court, together with an answer brief, at least 20 days before the date of the first hearing. If the defendant intends to file a counterclaim or join third parties to the litigation, the defense and counterclaim and/or third-party claim must be filed with the court, together with the answer brief.

3. Key Elements of Litigation

First hearings are generally held in the judge's chambers and are attended only by the parties' counsel. The judge checks the documents filed by the parties and asks for further clarifications, and also indicates issues that he or she deems opportune to treat immediately. Upon request of the parties, the judge sets the date of a next hearing, at which the parties are required to appear in person or through a legal representative, or grants the parties terms to file evidentiary briefs, whereby the parties may produce fresh documents, propose witnesses and other evidentiary means. The judge may question the parties and will attempt to promote a settlement of the dispute.

The evidence that can be adduced by the parties is regulated in detail. Witnesses must be heard in court, but upon all parties' request, and if required by the nature of the dispute or by any other specific circumstances, the judge may allow written depositions. The parties must identify in advance the names of their witnesses and submit a list of the questions to be asked of each of them. The judge decides on the admissibility of witnesses, determines which questions are to be put to the witnesses and addresses the questions to the witnesses. A party cannot cross-examine the other party's witnesses. However, each party may request the judge ask the witnesses to provide more precise information, although the judge has complete discretion as to whether to ask further questions. When it is necessary to ascertain specific circumstances regarding the case, the judge may order inspections and appoint an expert in order to carry out technical analysis or examinations, which, however, are not binding on the judge.

After examining the evidence, the judge fixes a hearing date at which he or she invites parties to state their final claim and defense by way of written submissions. Oral submissions are rare. The judge will decide a case based on evidence provided by the parties.

A party who is a creditor for a certain sum of money, or a right to delivery up of goods, who can provide written evidence of its claim may apply for an interim order for payment or delivery up. The defendant may file a defense within 40 days of the service of the order. If a delay might seriously impair the party making the order, or if a defendant fails to file a defense or appeal, then the order may be declared immediately enforceable.

Orders for payment or delivery up of goods can also be obtained during pending proceedings, where the claimant can provide written proof of its right, or where the order is limited to the amount acknowledged as due by the other party.

The appeals against a judgment may be in fact or in right and leave to appeal is not required.

An ordinary appeal may be lodged against a judgment given at first instance, except:

i. when excluded by a statutory provision;
ii. when excluded by the agreement of the parties;
iii. when the judgment has been given in accordance with the rules of equitable justice, rather than the rules of substantive statutory law; or
iv. when the judgment has been given by a justice of the peace, pursuant to the rules of equitable justice.

A cross-appeal can be made by the defendant with its response to the appeal. New claims may not be made in appeal proceedings. New evidence is inadmissible unless the court considers it essential to the final decision, or is satisfied the evidence could not have been produced before for reasons beyond the control of the party seeking to rely on it.

A petition to the Supreme Court can be filed against an appeal judgment or a judgment at first instance when it is not subject to appeal on certain grounds of right.[13]

The defendant/respondent may file a counter-petition. New documents are not allowed, except those needed to prove that the judgment is null and void or that the petition or the counter-petition is admissible. The Court of Cassation may set aside the judgment, remand the case to another court for a re-trial or dismiss the petition.

Appeal judgments and judgments rendered at first instance against which no ordinary appeal can be made may be attacked by a petition for revocation in certain situations.[14]

Third-party opposition is a remedy granted to someone whose rights are prejudiced by a judgment given in proceedings to which he or she was not a party.

4. Costs

As a general rule, the court orders the losing party to pay the legal costs and fees incurred by the successful party. The amount of costs is assessed at the end of the proceedings, according to official tariffs enacted by the Ministry of Justice and included in the judgment. If there is more

[13] (i) Jurisdiction; (ii) breach of the rules governing venue; (iii) breach or wrong application of statutory provisions; (iv) nullity of the judgment or of the proceedings; or (v) lack of, insufficiency or contradiction in the reasons of the judgment on a decisive issue that had been raised during the proceedings by the parties, or should have been raised by the court of its own motion. It is the creditor's burden to find debtor's assets that are likely to be sold in order to satisfy its credit.

[14] (i) The judgment was the result of mistake or fraud; (ii) the judgment has been rendered on the basis of false evidence; (iii) after the judgment, decisive documents have been found that a party could not produce in the proceedings; (iv) the judgment is in conflict with another judgment, unless the existence of that other judgment was argued before the court and the court found that no conflict exists; or (v) the judgment is affected by fraud on the part of the judge.

than one losing party, the court orders each one to pay legal costs and expenses and damages in proportion to their respective role in the case. Costs incurred as a result of one party failing to comply with the duty to act fairly during the course of litigation may be ordered. Cost liabilities may be exceptionally set-off between the parties in part or in full. The court may also disallow some of the costs incurred by the successful party if they are considered excessive or unnecessarily incurred.

5. Enforcement of Judgments

Any judgment and/or interim relief order can be enforced by means of enforcement proceedings.

For monetary claims, the judgment creditor must send a notice to the judgment debtor, informing him or her that enforcement proceeding will be commenced if he or she doesn’t comply with the notice within 10 days. After 10 days, the creditor can ask the court bailiff to seize the debtor’s assets and/or real estate.

Specific rules apply to enforcement proceedings aimed at having a specific object released or delivered and/or obliging the debtor to carry out a specific activity or preventing the debtor from carrying out a specific activity.

Foreign Judgments

Foreign judgments are automatically recognized in Italy, provided that the following requirements are complied with:

i. the court that gave the foreign judgment had jurisdiction over the case;
ii. the procedural documents commencing the foreign proceedings were properly served on the defendant and his or her rights of defense were respected;
iii. the parties entered a formal appearance or judgment by default was granted pursuant to law;
iv. the foreign judgment is no longer capable of appeal;
v. the foreign judgment is not contrary to any final judgment rendered by an Italian court;
vi. no litigation on the same subject and between the same parties, initiated before the foreign litigation, is pending before an Italian court; and
vii. the foreign judgment is not contrary to Italian public policy.

However, if a party objects to the automatic recognition of the foreign judgment, or whenever it necessary to commence enforcement, the interested party can begin proceedings before the Court of Appeal for the recognition and enforceability of the foreign judgment. The Court of Appeal’s decision on the matter can be appealed to the Supreme Court.

6. Arbitration

Arbitration is increasingly used as an alternative to court proceedings. Arbitration proceedings are classified into four categories:

i. formal arbitration, whose award may be enforced like a judgment;
ii. informal arbitration, whose award may be enforced as a contract;
iii. foreign arbitration; and

iv. arbitrations administrated by pre-established regulations.

Each is governed by a separate, though similar, set of rules [15]

Arbitration presenting elements of internationality (i.e., one of the parties having its residence or registered office outside of Italy) is now governed by the same rules as a domestic arbitration.

Italy is a signatory to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitration Awards and cooperates with international organizations in the promotion of arbitration.

Whenever a dispute is reserved to arbitration, the courts are required to decline jurisdiction. However, the courts retain jurisdiction to grant interim relief, such as injunctions or freezing orders.

Institutional arbitration is mainly handled by the Chambers of Arbitration. These Chambers give assistance in drafting arbitration clauses for contracts and in researching questions of arbitration conciliation and other related issues.

The activity of Chambers of Arbitrations, which is increasingly growing, includes the resolution of disputes in a quick and efficient way by means of arbitration and mediation, including online mediation.

While most Chambers of Arbitration in Italy are concerned only with domestic matters, the Chamber of Arbitration of Milan and the Chamber of Arbitration of Venice play an important role in resolving international disputes.

The Chamber of Arbitration of Milan has gained an increasingly good reputation for its ability to count on reliable arbitrators and mediators, and to work in several different languages, such as English, French and Italian.

The Chamber of Arbitration of Venice is mainly concerned with disputes arising out of commercial relationships with Eastern Europe, Austria, Germany, and the Middle and Far East.

For a foreign arbitration award to be enforced in Italy, it must be filed with the Court of Appeal of the place of residence of the other party (if it is in Italy) or with the Court of Appeal in Rome (if the other party resides abroad).

The court will only check the formal requirements of the award and will not identify any defects in the award that may entitle the parties to appeal.

An arbitration award is immediately binding on the parties.

7. Alternative Dispute Resolution

As mentioned above, with the introduction of the mandatory mediation process for a good number of controversies prior to commencing litigation proceedings, mediation is developing rapidly as a means of resolving domestic disputes.

ADR is also strongly fostered by the Chambers of Commerce, notably that of Milan, which has organized conciliation centres and established rules of procedure.

In labor cases, and cases involving subcontractors, the parties have the right to go through ADR procedures before they apply to court. The Code of Civil Procedure also provides for conciliation during court proceedings, upon request of the parties. Any settlement agreement

[15] The majority of the rules are found in the 1942 Italian Code of Civil Procedure.

entered into before the judge is binding and enforceable in the same way as a judgment of the court.

8. Interesting/Relevant Cases

In a case brought before the Tribunal of Palermo (decision of 1 March 2013) and concerning luxury products (decorative furniture), it has been held that the owner of a trademark may prevent third parties from selling products bearing the same trademark, when the marketing is done through a selective distribution system. Therefore, the behavior of a retailer who continues to market products of a given brand (legitimately purchased) even after the producer has made known that there is a selective distribution network, qualifies as unfair competition, insofar as the sale of products by the retailer in this case risks prejudicing the investments made by the manufacturer to promote the sales and to consolidate its image through the selective distribution network.

The Italian Supreme Court (judgment of 27 May 2013 n° 13090) has confirmed the principle that when a brand is very well known in the market, it enjoys a protection extended beyond the products for which the trademark has been registered, provided that the identity of similarity of the compared trademarks implies (i) the risk of a loss of image due to the undesired vicinity of the trademarks; and/or (ii) advantage resulting to the counterfeiter due to its passive behavior. In the subject case, a producer of suitcases had used for its products a trademark famous in the fashion industry.

L. Russia

1. Legal System

Russia is a federal state. The legislative, executive and judicial organs of the state are separate.

The Russian Constitution is the supreme legal authority of the Russian Federation.

The principal legislative instruments are federal laws.

Constituent entities of the Russian Federation (RF) are entitled (to the extent of their authority established by the Russian Constitution) to enact laws that are consistent with federal laws.

Generally accepted principles and rules of international law and international treaties of the RF form an integral part of the legal system. If an international treaty establishes rules other than those provided by Russian domestic law, the international treaty obligations take precedence.

Arbitrazh courts are based on those of European civil law jurisdictions. Intellectual property disputes are resolved by the Court of Intellectual Property Rights, which is part of the arbitrazh courts.

2. Commencing Proceedings

A court of first instance may start proceedings when a claim is filed. A claimant may file a claim by submitting it to the arbitrazh court in hard-copy form or by filing it electronically at a website of the relevant arbitrazh court. A claimant should deliver a copy of the statement of claim (setting out grounds for claim, all evidence and relevant supporting documentation) and all supporting documents to each party by registered mail.

The respondent files its statement of defense, setting out grounds for the rejection of the claim, together with any evidence in support of its case. There is no specified time frame in which to submit a defense stipulated by the Code of Arbitrazh Procedure. At the same time, the deadline for submitting the defense may be specified in the ruling on initiation of arbitrazh proceedings. Failure by the respondent to file the defense in a timely manner will not result in an automatic finding for the claimant; the proceedings will continue on the available documents and evidence. In the event the case cannot be heard without the statement of defense, the court may set another deadline for the submission thereof.

3. Key Elements of Litigation

Legal proceedings begun in a state arbitrazh court may be appealed three times.

Documents comprise the key evidence used by arbitrazh courts.

The Code of Arbitrazh Procedure also permits witness testimony. Hearing witnesses is the exception rather than the rule, since arbitrazh courts traditionally prefer to rely on documents as the principal proof.

The court, on the motion of a party, appoints experts in limited situations when expert knowledge is needed.

The court may order provisional remedies at any phase in the proceedings if requested to do so by a party.

Summary proceedings is an expedited procedure for resolving disputes on the basis of written evidence, which aims to reduce litigation costs and mitigate the caseload for judges.

A losing party may appeal a decision within one month. The court of appeal is required to review the appeal within two months. This may be extended upon the request of the judge.

A resolution of the court of appeal may be further appealed to the court of cassation appeal within two months. The court of cassation appeal is required to review the cassation appeal within two months. This may be extended upon the request of the judge.

A losing party may appeal rulings and resolutions of the court of cassation appeal to the panel of the RF Supreme Court within two months.

The cassation review at the Supreme Court is a two-tier process. A judge of the RF Supreme Court first resolves, within two to three months, whether there are grounds for review of the cassation appeal at the court session of the Supreme Court's panel. If transferred to the panel, the cassation appeal is to be considered within two months of the ruling on such transfer. A refusal to transfer the case for such review may be challenged, to the Supreme Court's chairman or deputy chairman. If the challenge is successful, the cassation appeal is transferred for review in the court session of the Supreme Court's panel.

The rulings of the RF Supreme Court's panel may be appealed to the court of supervisory review within three months of their becoming effective.

The supervisory review is also a two-tier process. A judge of the Supreme Court first resolves, within two to three months, whether there are grounds for the review at the session of the RF Supreme Court Presidium. If transferred to the Presidium, the supervisory appeal is to be considered within two months of the ruling on such transfer. A refusal to transfer the case for such review may be challenged, to the Supreme Court's chairman or deputy chairman. If the challenge is successful, the supervisory appeal is transferred for review at the session of the Supreme Court's Presidium.

The resolution issued by the Supreme Court's Presidium upon review of the supervisory appeal at its session cannot be further appealed.

It is possible to submit a motion to higher courts, together with the appeals, to suspend enforcement pending the resolution of such appeals; the courts will have discretion whether to grant the motion.

4. Costs

Litigation costs are to be recovered from the losing party. However, the court may order a party abusing its procedural rights to cover the costs of the proceedings irrespective of the outcome, if such actions resulted in the disruption of the court hearing, delay of the process, obstructing of the consideration of the case, and preventing the issuance of a legal and well-grounded court act.

Litigation costs include state duty and other costs associated with the proceedings, including witness and expert expenses, the costs of execution of the court judgment and legal fees. The court awards legal fees to the winning party within "reasonable limits", which, in practice, means minimal amounts.

An application for compensation of legal costs may be filed within six months of the entry into force of the last court act issued on the merits of the case.

A party is entitled to claim compensation for violation of its right to the resolution of a dispute within a reasonable time. The relevant application may be filed by the interested party within six months of the entry into force of the last court act issued in the case. It can be filed before the end of proceedings, provided that the case has been pending for over three years and the party has petitioned for speeding up the proceedings.

In addition, a party may claim compensation for violation of its right to a timely enforcement of a court act. The relevant application may be filed after the lapse of six months since the time frame established by the federal law for the execution of a court act, but before the expiration of six months since the end of the execution of the court act.

5. Enforcement of Judgments

The judgment in summary proceedings is subject to immediate enforcement.

Court judgments are enforced by the bailiff service.

A foreign court judgment may be enforced in Russia as long as it has been recognized by a Russian court. The court may recognize it if it is supported by a relevant international treaty or by federal law.

Despite a lack of direct regulation, Russian courts may recognize and enforce foreign court judgments on the basis of international comity and reciprocity.

6. Arbitration

As an alternative to the state arbitrazh courts, parties to foreign trade contracts are entitled to refer a dispute to a private arbitration tribunal, including *ad hoc* and institutional arbitration tribunals located either within or outside the RF.

The Law On International Commercial Arbitration follows the UNCITRAL Model Law.

Arbitration tribunals have the power to resolve disputes between individuals or legal entities both on private and commercial matters. The exceptions to the types of disputes subject to arbitration are stipulated in the federal law.

Arbitral awards rendered by arbitration tribunals located within or outside Russia are enforced by the bailiff service after the awards are recognized and enforced by the state courts. The courts may not review a decision of an arbitration tribunal on the merits of the case.

7. Alternative Dispute Resolution

Parties can voluntarily consent to appoint a mediator to assist in dispute resolution.

The mediation procedure may be applied to civil disputes, except if they affect public interests or rights and the legitimate interests of third parties that are not participating in the mediation procedure.

The mediation agreement concluded as a result of the mediation procedure cannot be enforced and is subject to voluntary performance by the parties.

Where the parties have reached a mediation agreement after the dispute has been referred to either a state court or arbitration, the court or arbitration tribunal may approve the mediation agreement as an amicable settlement.

8. Interesting/Relevant Cases

The RF Federal Service for Alcohol Market Regulation issued an order against a major multinational alcohol beverages producer, accusing it of deliberately providing the state authority with false information in the electronic declaration filed by the company. The company argued it was not guilty, as this was a result of a technical malfunction of the system.

The courts agreed with the arguments of the company and cancelled the order. In doing so, the courts found the company not guilty of committing the administrative offense, establishing that the company had taken all measures within its control to abide by the regulatory requirements but could not overcome the consequences of the technical malfunction.

The findings are important, as the courts ruled that there was no automatic liability of a legal entity but that it was entitled to the lack of guilt defense.

Chapter 11: Employment Concerns for the Industry[1]

I. Introduction

A. Overview of Labor and Employment Issues Impacting the Industry

The fashion industry is highly globalized and labor intensive, providing employment to over 60 million workers around the world.[2] The apparel industry can generally be divided into high-end and low-end production and brands. High-end production requires a more highly skilled workforce, while low-end production is characterized by lower-skilled and lower-paying jobs. The types of workers employed, employment relationships, working conditions, and related employment challenges vary throughout the supply chain, from the raw material network, to textile companies and garment manufacturers, to retail outlets.[3]

As employers continue to confront economic and market challenges, including cost competitiveness, low profit margins, high volatility and product innovation, they must also ensure compliance with labor and employment standards, laws and regulations in jurisdictions around the world.

II. Employment Relationships and Documentation

A. Overview

The apparel industry has a wide variety of employees, including a large number of unskilled workers, young women, migrants, and workers on short-term contracts.[4] Most fashion industry and luxury brand companies have the following types of employees: (a) managers; (b) office staff (including designers, finance/accounting, human resources and marketing); (c) retail sales employees; and (d) supply chain and manufacturing production workers (where applicable). The types of employment relationships and documents used to engage workers vary from jurisdiction to jurisdiction.

A key consideration for luxury and fashion industry companies is the maintenance of brand and image continuity in markets around the world. As luxury and fashion industry companies

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[2] http://www.ilo.org/global/industries-and-sectors/textiles-clothing-leather-footwear/lang--en/index.htm; accessed on 16 February 2015.

[3] *Wages and working hours in the textiles, clothing, leather and footwear industries, Issues Paper for discussion at the Global Dialogue Forum on Wages and Working Hours in the Textiles, Clothing, Leather and Footwear Industries* (Geneva, 23-25 September 2014).

[4] *Ibid*

continue to globalize,[5] expatriates from the global headquarters often play an important role in regional management, raising tax, immigration and employment issues relating to the local employment and/or international assignment of the foreign expatriate manager.

Most office employees are employed on a full-time basis. In some cases, luxury firms may use temporary or other contingent workers to provide highly specialized skills and greater flexibility, or to bridge gaps and/or manage costs. Project-based employees, outsourcing/dispatched employees and independent contractors are the most commonly used contingent workers.

By contrast, some retail store, supply chain and factory employees may be engaged as part-time employees or outsourced/dispatched employees. These types of arrangements can provide companies with greater flexibility to manage their workforce based on work demands, seasonal fluctuations and business structure. Student interns are also common, usually in a management or retail training capacity.

While contingent worker arrangements offer flexibility, the challenge of using temporary and other contingent workers cannot be overestimated. As the trend toward more flexible labor increases, so do concerns about the social effects of a disenfranchised workforce. It is no surprise then that global scrutiny and regulation of contingent worker arrangements is on the rise.[6] A collaborative global approach to managing the legal compliance and other risks associated with temporary and other contingent workers is essential to maximize the benefits of a flexible workforce.

B. Types of Workers and Requirements

1. Full-time Employees

A written employment contact may be required for the establishment of a full-time employment relationship in some jurisdictions. In China, for example, the employer generally must conclude an individual written employment contract with each full-time employee. The concept of "at-will employment" does not exist; however, the parties can decide whether an employment contract will have a fixed term or an open term. Employment contracts (regardless of whether they are open-term or fixed-term) can only be lawfully terminated by the employer on certain statutory grounds. The individual employment contract must include the basic legally mandatory terms. If no employment contract is signed within one month of the commencement of an employee's work, the employee is entitled to 200 percent of the employee's wage; if no employment contract is signed within one year after the commencement of an employee's work, the parties shall be deemed to have concluded an open-term employment contract.

In Japan, in contrast, it is not mandatory to provide employees with an employment contract, but the employer must provide the employee with a written "statement of working conditions" upon hiring. An employment contract can be used in lieu of the written statement. The statement of working conditions or employment contract must contain certain provisions, such as the term of employment, the workplace and duties of the employee, wages and working hours. If the company

[5] *The Talent Agenda – A State-of-the-Industry Briefing on People and HR Management, Luxury Society Report*, July 2010.
[6] Baker & McKenzie, *The Global Employer: A Global Flexible Workforce: Temporary and Other Contingent Workers* (May 2013).

has work rules, then the employment contract can be simplified by referring to the detailed provisions in the work rules.

In other jurisdictions, such as the United Kingdom, a contract of employment may be either written, verbal or implied by law. In most cases, employees will have a written contract, or at least a written statement of terms and conditions. Terms, including the circumstances under which the employer can terminate the employment, may be set out in a staff handbook or other document. From a contractual perspective (subject to unfair dismissal legislation), most contracts can be terminated at any time by giving a certain period of notice, which will normally be set out in the terms and conditions. If the terms and conditions do not expressly state what the notice period is, the courts will impose a "reasonable" notice period. Sometimes the terms and conditions will also contain provisions setting out certain dismissal procedures, which need to be followed before an employee is dismissed.

In many jurisdictions, employment relationships are highly regulated; in particular, with regard to termination of employment. In France, for instance, numerous sources of law govern employment relationships, including the Labor Code, collective bargaining agreements, and case law of the French Supreme Court (*Cour de Cassation*). In addition, employers must consider Internal Regulations (*Réglement Intérieur*) in effect, custom and usage, and individual employment contracts. After a probationary period, an employment contract can only be terminated in certain circumstances, depending upon whether the contract is entered into for a fixed term or an indefinite term. The majority of employees in the European Union (EU) are employed on an indefinite contract basis.

In other countries, employees have relatively limited rights in the context of employment. Under the "at-will" employment rule in the United States, an employer is generally free to terminate an employee for any reason or no reason at all, with or without previous notice, and at any time. Absent a contract or employer policy to the contrary, an employer can terminate an employee without any financial obligation to the discharged worker. In essence, an employee works at the will of the employer. Outside of the mass layoff or plant closing context, there is no federal law in the U.S. providing notice rights or indemnity requirements in the context of the termination of an individual employee. The at-will employment rule, however, is not interpreted uniformly in all 50 states. Courts in some states interpret the rule broadly, while courts in other states have created exceptions to the rule or otherwise restricted the application of the at-will employment doctrine. In addition, some states provide statutory protections against terminations that narrow the application of the rule.

A significant exception to the "at-will" employment doctrine is a written employment contract that sets forth an employer's obligations and employee's rights during and upon termination of employment. In the U.S., most employees do not work under an employment contract. Written employment contracts are generally only provided to executives, professionals, or highly technical or other specialized employees.

2. Part-time Employees

Jurisdictions around the world define "part-time employees" differently. In Japan, part-time employees are employees whose specified normal working hours are not less than 20 but less than 30 per week. In China, part-time employment is defined as a form of employment under which the employee generally averages not more than four hours of work per day and an accumulated total of not more than 24 hours per week for the same employer. Unlike full-time employment relationships, for which written employment contracts are required in some jurisdictions, an oral contract may be permissible and sufficient for part-time arrangements.

Part-time employment is increasing in many countries, particularly in the retail sector, as retailers seek to cover evening and weekend hours and seasonal peaks and manage costs. In the U.S., about one in three retail salespersons worked part-time in 2012, according to Bureau of Labor Statistics. Part-time employment can be a flexible option to encourage greater workforce participation, including by women, students, older workers and others who do not want full-time or permanent employment. It can also lead to underemployment if part-time workers desire full-time employment.

The types of arrangements and flexibility available to employers vary by jurisdiction. Efforts are underway in some jurisdictions to limit employers' "just in time" or "on-call" scheduling practices to manage a part-time workforce. In, e.g., the U.S., retailers are under increasing pressure from some workers, unions, advocacy groups and lawmakers to provide part-time workers with more rights. San Francisco's "Retail Workers Bill of Rights", which covers many chain fashion retailers, requires employers to, among other things, pay part-time employees the same starting hourly wage as full-time employees in the same position, to offer additional hours of work to current part-time employees before hiring new employees or subcontractors, and to provide part-time workers with the same access to time off and promotions enjoyed by full-time workers. Other laws give employees the right to request flexible or predictable schedules to allow for the care of children or aging parents. Industry employers are closely monitoring new laws, which can significantly impact scheduling and labor costs.

3. Independent Contractors

In a highly competitive industry that values speed, responsiveness and human talent, the use of contingent workers can bring numerous benefits. Many fashion companies engage independent contractors to perform design, marketing, sales and other functions. Individuals who are properly classified as independent contractors are not employees. They perform their work based on a contract that specifies their compensation and other terms and conditions. A company's designation of a worker as an independent contractor, however, does not automatically make the employee an independent contractor.

While independent contractor relationships are recognized in most jurisdictions, the potential for misclassification of independent contractors and the commensurate liabilities are global concepts. The exposure for contractor classification can be significant, and include actions by the government for failure to withhold taxes and social security, plus penalties and interest, as well as claims by the alleged independent contractor for employment law protections and entitlements such as overtime compensation, meal and rest breaks, vacation or sick pay benefits, termination rights and other employee benefits. Some countries also provide for criminal penalties.

With some variation from jurisdiction to jurisdiction, legal tests to determine whether a worker is an independent contractor generally focus on how much control the company has over the worker, which can include factors such as who provides supplies and tools; the location of the work; the length of the engagement; and how the worker is paid. It is important to use a properly drafted independent contractor agreement; however, the agreement is not ultimately determinative, as courts and government agencies look at the realities of the relationship. Globally, substance governs over form. In addition, some jurisdictions (e.g., Chile, Mexico, Portugal, South Africa, and California in the U.S.) presume an employment relationship. Accordingly, to minimize wage, working time and other employment risks, companies must make informed decisions when engaging independent contractors to ensure the arrangement will meet their needs and comply with applicable laws and regulations.

4. Staffing Agency/Dispatched Workers

In the event of a significant and temporary increase in business demands or to replace an employee who is not working for some reason (e.g., vacation, sick leave or maternity leave), industry employers may engage staffing agency/dispatched workers to satisfy temporary employment needs. The use and availability of temporary workers vary by jurisdiction. In most countries, the use of agency workers is allowed, but strictly regulated.

The employment of agency workers is a tripartite relationship among the agency worker, staffing agency and host company. The documentation for this type of employment generally involves a contract between the staffing agency and the host company; a contract between the staffing agency and the agency worker; and, in some cases, a supplementary agreement between the host company and the agency worker.

The contract between the staffing agency and the host company is specifically regulated in most jurisdictions. For example, in Germany, this type of contract, called a labor lease contract, must be in writing and contain specific information, including whether the staffing agency is in possession of a governmental license, and the specific professional qualifications required for the position. Additionally, in most countries, such as Germany, France, Italy, China, Japan and Brazil, the staffing agency must have a license authorized by the competent government authorities in order to dispatch/lease workers to the host company. In other countries, such as the UK and the U.S., the market for staffing agencies is less regulated, and agencies generally do not require licenses to operate.

The engagement of agency workers is usually subject to various restraints. In China, for instance, employers are only allowed to use staffing agency/dispatched workers as a supplemental hiring method for temporary, auxiliary and substitute job positions, with a limit of up to 10 percent of the employer’s workforce (including directly hired employees and agency workers). Employers are further prohibited from discriminating against dispatched employees in terms of benefits. In Japan, an agency worker may be used for only one year, in principle. This can be extended to three years by following certain procedures. However, this limit on the duration does not apply to various specified types of specialized work.

Companies that fail to comply with rules governing the use of agency workers risk the invalidation of contracts, damages to the agency workers, re-categorization of the arrangement into one of direct employment or a joint-employer relationship, administrative penalties or even criminal sanctions.

5. Outsourcing Arrangements

Most companies in the fashion industry rely on a business model that involves outsourcing. Few luxury brands generate the majority of their revenues via company-owned monobrand stores (i.e., flagship stores). While luxury brands continue to invest in their store networks, significant revenue is typically generated via specialized multi-brand retailers.[7] In addition to retail store sales, various stages of production, such as purchasing raw materials, designing, cutting, dyeing, sewing, packaging, and distribution, are frequently outsourced or subcontracted to other companies around the world.[8]

Outsourcing arrangements are based on the service agreement between the luxury firm and the company that provides the required services. Unlike in the case of labor agency/dispatch arrangements, under an outsourcing arrangement, the company providing services has full supervision of and control over the employees performing those services. Common risks related to subcontracting include that of re-categorization and illegal transfer of employees. In, e.g., Spain, the arrangement between the two companies could give rise to an illegal transfer of employees if the client company is acting as the real employer of the employees of the outsourcing company. Any illegally transferred employee is entitled to become an indefinite-term employee at either company, if the employee chooses. In addition, both companies will be jointly and severally liable for all employment and social security obligations with respect to the employees transferred. Illegal transfer is also subject to substantial fines, and, in extreme cases, could expose the company to criminal liability.

In addition, there are significant intrinsic risks at all subcontracting levels. The increasing use of third parties in supply chains is creating major compliance and brand risks for industry employers. Governments around the world have been passing and enforcing an expanding list of laws that require companies to scrutinize and police those acting on their behalves. As a result, companies must take a coordinated, integrated approach to how they structure their supply chains and assess and manage their risk at key stages of a third-party relationship: i.e., vetting and selecting potential suppliers/partners, structuring and documenting, training and educating, monitoring and evaluating performance, and reacting to gaps and risks.[9]

6. Internships and Apprenticeships

Interns are often engaged by fashion and luxury brands in areas such as marketing, merchandising, production and communications. The requirements and documentation needed for internship agreements, vocational training contracts, apprenticeship contracts or labor service contracts differ from jurisdiction to jurisdiction.

While internship programs have long been a part of the industry, unpaid internships have come under attack in recent years in certain parts of the world. For example, in the U.S.,

[7] *Measuring and Managing Service Performance of Luxury Stores: Development of a Balanced Scorecard*, Marcella Ehbauer, Ronja Gresel, EBS Business School.
[8] French National Contact Point for Implementation of the OECD Guidelines for Multinational Enterprises, *French NCP Report on Implementation of the OECD Guidelines in the Textile and Clothing Sector* (2013); available at http://www.uscib.org/docs/2014_04_15_CR_Committee_FrenchNCP.pdf (accessed on 30 June 2014).
[9] *The Companies You Keep, Global Supply Chain Management: Five Steps to Managing Third-Party Risk*, Baker & McKenzie (August 2013).

employers, including luxury brands, retailers and media companies associated with fashion brands, have seen an increase in the number of wage and hour lawsuits filed by unpaid interns in the wake of a 2013 ruling by a New York federal district court holding that a film distribution company violated minimum wage laws by not paying interns working on a movie. In 2014, a federal district court in New York approved a US$450,000 settlement between a model management company and a proposed class of unpaid interns who worked for the company during Fashion Week. The complaint alleged that the company knowingly misclassified the workers as unpaid interns, and failed to pay them minimum wages and overtime compensation under the New York Labor Law and the federal Fair Labor Standards Act (FLSA).

The U.S. Department of Labor uses a six-point test to determine when interns should be paid. It includes whether the internship focuses on training, whether the training is for the benefit of the trainees, and whether the intern does the work of a regular employee.

Similarly, other jurisdictions have passed legislation on internships. In France, new laws have strengthened existing measures and introduced requirements offering more protections for interns. Industry employers should carefully review the structure of any internship program to ensure it satisfies all criteria under the relevant laws.

Various apprenticeship systems also exist in certain jurisdictions, including in many EU countries. “Formal” apprenticeship is structured and regulated, usually by legislation at the national level; is paid; is centered on the workplace; and is based on a contract that specifies time, a learning program (including transferrable skills), assessment and final certification, and entitlement to off-the-job learning. The German-speaking dual-system countries (Austria, Germany and Switzerland), e.g., have a strong apprenticeship tradition. In Germany and Switzerland, approximately two thirds of all young people embark on apprenticeship training.

Unlike other apprenticeship programs in Europe, apprenticeship in the UK is not governed by a statutory framework. This means that, while employers must ensure that apprentices receive training, this can be provided on the employers’ premises, and employers are under no obligation to release students for off-the-job training or to adhere to a specified term of apprenticeship. Apprentices in the UK, however, are required to work toward a recognized national skill qualification. They are also entitled to the national minimum wage and paid holidays.

Industry employers in many countries are interested in increasing capacity in traditional areas such as yarn-spinning, knitting and weaving, in addition to more modern areas such as textiles, materials and composites.[10] To address barriers to growth, including an aging workforce and skills shortages, industry employers in some countries are investing in talent and the development of professional skills by promoting cooperation between vocational education and training (VET) providers and the apprenticeship system. The National N Brown Textiles Growth Programme, e.g., helped create 1,600 jobs and 115 apprenticeship positions in the UK in its first year. The repatriation of textile manufacturing to the UK is supported by retailers including N Brown, M&S, ASOS and Roland Mouret.[11]

[10] he Alliance Project Team, *Repatriation of UK textiles manufacture* (January 2015), accessed at http://neweconomymanchester.com/stories/2045-investment_in_textile_manufacturing_to_create_20000_jobs_in_the_uk_by_2020_according_to_the_alliance_report_
[11] *Ibid*.

While internship and apprenticeship programs can provide mutual benefits for workers and employers, industry employers should ensure all programs comply with applicable laws to minimize employment law risks.

7. International Secondment

When management employees of global/regional headquarters work for a fashion company's local entities around the world, an international secondment is commonly used in jurisdictions that do not require a local employment contract for immigration or other local employment law purposes. Under the international secondment arrangement, the affected employee will continue to be employed by a foreign entity (e.g., the global/regional headquarters) and will be assigned/seconded to work at the local entity. This will usually allow the manager to maintain his or her employment relationship and the benefits he or she has with the offshore employer during the term of the secondment to the local entity.

In the typical secondment arrangement, the employee will sign an international assignment/secondment letter with the offshore home country employers, and the home company employer will enter into an intercompany secondment agreement with the local entity to set forth the commercial arrangements between the two companies, typically with respect to the reimbursement of the employee's salary and other employment costs. There may, however, be certain permanent establishment (PE) tax implications for the offshore entity employer if the employee is deemed to be "doing business" in the local jurisdiction through the seconded employees. Although there may be several advantages to an international secondment arrangement, companies should carefully consider the offsetting tax issues and the management resources required to maintain such a structure.

III. Anti-discrimination and Anti-harassment

A. Overview

Anti-discrimination and harassment laws vary significantly around the world. Even among jurisdictions with laws that are facially similar, the practical enforcement, remedies and potential liability that employers face can vary significantly. As a general rule, employers in most jurisdictions are prohibited from discriminating against employees on the basis of race, religion or other minority status, in terms of recruitment, terms and conditions of employment, promotion and terminations. The particular categories of protection can vary significantly across jurisdictions.

In some developed jurisdictions, such as the U.S. and EU countries, discrimination laws are sophisticated and well enforced, while in several developing jurisdictions, although legal protections may exist, practical enforcement may be relatively weak.

B. Discrimination

1. Protected Categories

Most countries have some form of anti-discrimination laws that prohibit employers from discriminating against certain types of employees often on the basis of race, national origin, nationality, religion and/or gender. There can be significant variation as to the specific, protected categories in each jurisdiction. For example, military veterans are protected in the U.S., part-time employees are protected in the EU, political opinion is protected in Argentina, and infectious disease (such as hepatitis B) carriers are protected in China.

Countries also take different approaches with respect to the same protected categories. In the U.S., age discrimination is prohibited against employees over 40; in the EU, age discrimination is prohibited, but there is no minimum protected age; in many jurisdictions in Asia, such as Indonesia, China and Hong Kong, age is not a protected category.

The scope of discrimination laws with respect to sexual orientation likewise varies from country to country. Many countries, such as France, Germany, Canada, Italy and the UK, prohibit discrimination based on sexual orientation. Even in countries without specific laws prohibiting discrimination on the basis of sexual orientation, lesbian, gay, bisexual and transsexual (LGBT) individuals may be protected, based on discrimination laws prohibiting sex discrimination or sexual stereotyping. In the U.S., federal legislation (in contrast to state laws) does not specifically prohibit discrimination based on sexual orientation. The Equal Employment Opportunity Commission and some courts, however, have held that Title VII of the Civil Rights Act of 1964 does cover gender identity and sexual orientation discrimination when the discrimination is targeting an individual based on the individual’s sex. Similarly, in Hong Kong, individuals experiencing discrimination due to sexual orientation or on the basis of their transgender status have brought claims under narrow provisions within the Sex Discrimination Ordinance or the Disability Discrimination Ordinance. In some countries, especially in parts of Africa and the Middle East, homosexuality may be a criminal offense and/or LGBT individuals are restricted from accessing equal rights before the law.

Weight is an appearance issue that can generate litigation. In the U.S., discrimination based on weight alone does not violate Title VII. A plaintiff, however, may be able to prove sex discrimination if the employer treats men and women differently with respect to weight. Weight discrimination claims may also be cognizable under federal or state laws if the plaintiff can show that his or her weight is a “disability” within the meaning of the laws. In addition, industry employers should be aware of applicable state and local laws. Michigan and some cities (e.g., Madison and Wisconsin) have laws prohibiting discrimination based on “physical characteristics” such as weight.

2. Direct and Indirect Discrimination

There are two principal types of illegal employment discrimination: (1) direct discrimination (referred to as disparate treatment in the U.S.); and (2) indirect discrimination (referred to as disparate impact in the U.S.).

Direct discrimination occurs when a person is treated less favorably than another on the basis of a protected ground. For example, not promoting an employee because of his or her sex or race is discriminatory. Most countries prohibit direct discrimination in the workplace. Indirect discrimination occurs where a provision, criteria or practice that is neutral on its face has an adverse effect on persons in a protected category. For example, a height requirement (i.e., that job candidates be 180 centimeters tall) may indicate indirect discrimination because of gender.

Luxury and fashion industry companies may be subject to indirect discrimination claims based on attempts to maintain a certain "brand image" if hiring and employment criteria impact a protected category of employees. In both the U.S. and the UK, employees have sued fashion retailers for discrimination on the basis of race and disability, among other protected categories. While federal laws in the U.S. do not prohibit discrimination based on appearance unrelated to a person's sex, national origin, race, color or religion (or other protected category), plaintiffs frequently advance aesthetic-based claims within the Title VII framework. For example, plaintiffs have brought class action lawsuits against retailers seeking millions of dollars in damages based on allegations that retailers failed to hire minority applicants or, if hired, prohibited minority employees from working on the sales floor because they did not fit the companies' image or brand in violation of Title VII.

Unlike direct discrimination, the concept of indirect discrimination as it exists in the U.S., Canada, the EU and other countries, is not well developed in many other jurisdictions, such as Indonesia, Vietnam and Mexico.

Fashion industry employers can also face an increased risk of discrimination claims based on dress, grooming and other appearance policies. While employers generally can adopt policies regulating employee appearance (e.g., facial hair, hair length, clothing, accessories, jewelry, piercings and tattoos) in the workplace to promote a certain image or professional appearance and for health and safety reasons, such policies should not have a disparate impact on a protected class and should be enforced in a non-discriminatory manner.

In addition, several countries have developed the concept of "reasonable accommodation", which means that employers must make reasonable accommodations for employees and/or candidates to comply with anti-discrimination statutes. In the U.S., e.g., a reasonable accommodation requirement is applicable for disability (such as making existing facilities readily accessible to employees) and religious discrimination (such as allowing an employee to wear a Muslim hijab or a Sikh turban when a grooming policy prohibits headgear). Courts have also held that tattoos, dreadlocks and piercings are religious practices under federal discrimination law if worn by the individual for religious reasons. In Canada and South Africa, the duty of reasonable accommodation – which had its origin in religious discrimination – now extends to several other grounds.

Sex-differentiated grooming and appearance codes may be permissible in certain circumstances. In the U.S., e.g., a "bona fide occupational qualification" (BFOQ) exception applies where the employer can prove that an employment preference based on a protected class characteristic – sex, religion, national origin or age – is reasonably necessary to the normal operation of its business. The exception, however, is narrowly construed and limited to occupations such as modeling, in which physical attributes are considered essential to job performance.

3. Remedies

Legal remedies for discrimination may include a monetary award (such as compensatory damages and punitive damages), injunctive relief, equitable relief, administrative fines, and/or even criminal liabilities in different jurisdictions.

In the U.S., discrimination claims and lawsuits are relatively common. In the 2014 fiscal year, the Equal Employment Opportunity Commission (EEOC) reported 88,778 individual discrimination charges. In addition to brand risk, employers sued for discrimination can face significant liability. Class action lawsuits alleging discrimination and harassment can cost employers millions of dollars to resolve.

Compensatory damages are generally for the alleged pain and suffering experienced by the employee injured by the employer's discriminatory conduct, while punitive damages are in the form of a penalty and are imposed to deter wrongful conduct or to punish a lawbreaker. While compensatory damages are commonly provided, only a few jurisdictions (such as the U.S. and Hong Kong) provide for punitive damages.

In several countries (e.g., France, Belgium and Italy), courts may rule that discriminatory decisions are invalid. For example, in a case where a salary increase is denied, courts may order a salary adjustment. In addition, an employee may be entitled to reinstatement of employment if the termination is discriminatory. In other jurisdictions, the laws do not have clearly defined remedies or damages for unlawful discrimination. For example, while laws in China prohibit employers from discriminating against employees or candidates on the basis of sex, nationality, race, religion, disability, being a communicable disease carrier or being a migrant worker, they do not clearly define remedies or damages for unlawful discrimination. In practice, most anti-discrimination laws are not rigorously enforced, and anti-discrimination enforcement actions are few. In the absence of any clear damages or stipulated remedies, employees may find it difficult to claim monetary damages, since the harm suffered is of such an abstract nature.

C. Sexual Harassment

1. Types of Claims

The legal and practical prohibitions, remedies and enforcement actions with respect to sexual harassment in the workplace vary widely from place to place. As a baseline matter, many jurisdictions now prohibit sexual harassment in the workplace as a matter of law. Harassment is generally prohibited as a form of discrimination and/or a form of invasion of privacy, or as a tort in the form of an improper or illegal touching or assault.

Sexual harassment may be broadly defined to include unwelcome or unwanted sexual advances, requests for sexual favors, and other verbal, non-verbal or physical conduct of a sexual nature. Sexual harassment is often categorized as a "quid pro quo" or "hostile working environment", based on U.S. Supreme Court decisions. Quid pro quo sexual harassment occurs when employment decisions on hiring, promotion, transfer, discipline or termination are made on the basis of submission to or rejection of unwelcome sexual conduct. Hostile environment sexual harassment occurs where conduct of a sexual nature creates an intimidating, hostile or offensive working environment. It can take many forms, including verbal abuse, discussing sexual activities, commenting on an employee's physical attributes or appearance, uttering demeaning sexual terms, using crude and vulgar language, making unseemly sexual gestures or motions, engaging in unnecessary touching, or any of these types of activities in combination or if repeated over time. Many jurisdictions prohibit these forms of sexual harassment.

2. Employer Obligations

Almost every sexual harassment law imposes a duty on employers to prevent sexual harassment in the workplace. This may include complying with various requirements, such as formulating anti-discrimination and anti-harassment policies, providing training, establishing complaint procedures, and/or investigating complaints. In California, employers are required to provide periodic training on sexual harassment; in the Philippines, employers are required to issue rules to regulate employee behaviors through statutory procedures; in Australia, it is recommended that employers investigate allegations of sexual harassment. In other countries, such as China, the national law is silent on the specific measures an employer should take to prevent sexual harassment (although some local regulations provide guidance on an employer's obligations).

3. Employer Liabilities

In a number of jurisdictions, employers may be held liable for sexual harassment in the workplace. In the U.S., employers can be held legally responsible for supervisors who sexually harass employees if the supervisor's harassment results in a "tangible employment action", such as a significant change in employment status, including hiring, firing, failing to promote, reassignment of significantly different responsibilities or a decision causing a significant change in benefits. Employers can be held liable for sexual harassment by non-supervisors, co-workers, customers, vendors or independent contractors, based on negligence standards. The employer can be held liable if it "knew or should have known" of the harassment, but failed to take corrective action.

In Hong Kong, an employer will be vicariously liable for its employees' sexual harassment conducted in the course of their employment, whether or not such conduct was with the employer's knowledge or approval, unless the employer took reasonable steps to prevent the unlawful act. In Brazil, sexual harassment in the workplace may be considered a violation of the employment relationship by the employer, and thus entitles employees to terminate the employment contract for cause and claim moral damages.

4. Moral Harassment

In addition to discriminatory sexual harassment, several jurisdictions (such as France, Germany, Spain, the UK and Brazil) also prohibit non-discriminatory harassment: i.e., harassment not based on protected grounds. This type of harassment may be referred to as a type of bullying, mobbing, or moral harassment, and may be defined as repeated, unreasonable acts to intimidate or undermine the health or safety of employees.

5. Other Discrimination Issues

Discrimination issues can arise outside the employer–employee relationship. For instance, in recent years, "racial profiling" allegations against fashion retailers have made headlines in the U.S. In 2013, the New York State Attorney General launched an investigation into the security practices of several retailers following complaints that African-American shoppers were unfairly detained and questioned. Minority shoppers have also sued retailers for false imprisonment, assault and battery, negligent hiring and civil rights violations. In 2013, a coalition of retailers and civil rights leaders in New York City agreed to a "bill of rights" to protect customers from racial profiling.

Fashion industry brands have also been criticized for their hiring of primarily white models. For example, the *Jezebel* blog publishes the number of diverse models featured in New York Fashion Week.[12] While models are generally considered to be independent contractors in many jurisdictions, including the U.S., and thus may not be covered under many anti-discrimination laws, prominent models and organizations can target for adverse publicity those fashion brands and designers who do not use minorities.

D. Recommendations

1. Adopt an Anti-discrimination and Anti-harassment Policy

Various legislation and court decisions across jurisdictions make it clear that an anti-discrimination and harassment policy can help prevent discrimination and harassment in the workplace, and serve as an employer defense to discrimination and harassment claims. Furthermore, such a policy can be critical support for any disciplinary decision against an employee who has engaged in discriminatory or harassing behavior.

Since discrimination and harassment rules vary by jurisdiction, industry employers generally formulate rules tailored to each applicable country's laws. In several jurisdictions, for a discrimination and sexual harassment policy to be effective, it must be adopted through statutory procedures.

2. Implement Training Programs

Several countries require employers to implement anti-discrimination and sexual harassment training programs. Even in the absence of a requirement, training is important to inform employees of their rights, as well as to ensure managers understand what constitutes acceptable behavior and how to respond to inappropriate or unlawful behavior in the workplace.

3. Establish Complaint and Investigation Procedures

Employees should have a method of reporting concerns about discrimination and sexual harassment. Companies may allow complaints of discrimination/sexual harassment to be reported

[12] http://jezebel.com/new-york-fashion-week-diversity-talks-but-white-faces-1522416724

through a whistleblower hotline or appoint a trusted point of contact to hear complaints. Employers should properly investigate and respond to employee claims and, where warranted, institute prompt remedial measures to prevent further occurrences of discrimination and harassment. These procedures can potentially limit or avoid employer liabilities, and may help to establish a discrimination-/harassment-free work environment. In addition, employers should protect the privacy of an employee who files a complaint, as well as that of those involved in the investigation, and avoid retaliation against employees.

IV. Wages and Hours

A. Overview

Global wage and hour compliance is one of the most pressing issues facing fashion industry employers. Wage and hour challenges on both the production and retail side have intensified as the pace of fashion has increased. Fashion companies must get their products from design to the sales floor quickly to satisfy customer demand for new styles, straining operations and the supply chain in a highly intensive labor industry. At the same time, failure to comply with applicable wage and hour laws across jurisdictions can result in significant liability in the form of employee claims and litigation, government enforcement actions, civil and criminal fines and penalties, and reputational brand damage.

B. Minimum Wages

Minimum wage laws generally prohibit employers from paying employees or workers less than a set minimum hourly, daily or monthly wage. Most jurisdictions have adopted minimum wage laws. The global landscape, however, is complex. The minimum wage framework – including how wage levels are set (e.g., statute, decision of wages boards or councils, court rulings, collective bargaining agreements), the criteria used to determine the minimum amounts, the frequency with which they are updated, and whether and how they are enforced – differs from jurisdiction to jurisdiction.[13] It is critical to identify applicable laws at every level to accurately evaluate legal compliance and risk.

Most countries have adopted minimum wage legislation at the national, provincial and/or local level. In, e.g., the U.S., the Fair Labor Standards Act (FLSA) establishes minimum wage and hourly pay requirements for employees nationwide. Some states and municipalities, however, have higher minimum wage rates. The employee is entitled to receive the highest applicable minimum rate.

In other countries, national minimum wage rates are fixed at different levels for various regions, zones or economic sectors. In, e.g., Mexico, the minimum wage is determined annually by the National Minimum Wage Commission and varies for each of the three geographic zones into which the country is divided. Under China's minimum wage system, minimum wage levels are fixed by the local governments and adjusted regularly based on guidelines in the Minimum

[13] Sangheon Lee et. al., *Working Time Around the World* (Routledge 2007).

Wage Regulations. Because calculations are based on local conditions, minimum wage levels can differ substantially across the country.

In many jurisdictions, the general minimum wage rates are fixed by reference to occupation or industry. In Australia, the General Retail Industry Award 2010 (Retail Award) applies to certain employers and employees in the retail industry and outlines minimum hourly rates of pay, as well as the most commonly used penalty rates for weekends, shifts, overtime, loading and allowances. Other minimum wage laws factor in various criteria, such as apprenticeship status, age and skill level (e.g., unskilled, semi-skilled or skilled).

While some wage/hour requirements may be modified pursuant to an individual employment contract or a collective bargaining agreement, most legal requirements are considered non-waivable and cannot be modified by agreement.

Some countries do not mandate a minimum wage but instead rely on employer groups and trade unions to negotiate minimum wages through collective bargaining.

Campaigns to raise the minimum wage are taking place in some more economically developed countries. Several European countries have been adjusting their minimum wage policies. In the U.S., as of 1 January 2015, 29 states and the District of Columbia have minimum wages above the federal minimum wage. Upward adjustments to the minimum wage can have a significant impact on the retail sector, which tends to employ a larger pool of minimum-wage workers in many countries.[14]

Similarly, the minimum wage in many garment-exporting countries is rising, challenging the industry to find new ways to reduce costs other than by production-sourcing decisions. China, the global leader in garment exporting, is a clear example. During the first three months of 2014, nine out of China's 32 provinces raised monthly minimum wages by an average of 13.2 percent.[15] China's Ministry of Human Resources and Social Security has suggested in its five-year plan that minimum wages rise at least 13 percent per year during the course of the current five-year plan, which runs to 2015.

Despite wage hikes, reports show that wages for garment workers in many leading apparel-exporting countries have fallen in real terms.[16] Ensuring adequate wages for workers remains a challenge for the industry, which can be complex and geographically dispersed, with various stages of production outsourced and subcontracted to suppliers around the world.[17]

The legal minimum wage differs from the concept of a living wage, which is generally defined as the wage needed for a working person to support himself or herself and his or her family in a manner considered acceptable by society. The concept of a living wage is embedded in international declarations and conventions, including the preamble to the Constitution of the International Labour Organization (ILO)[18] and the United Nations (UN) Universal Declaration of

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[14] *Characteristics of Minimum Wage Workers: 2012*, Bureau of Labor Statistics, accessed at http://www.bls.gov/cps/minwage2012tbls.htm#5

[15] *China urban jobless rate edges down to 4.08 percent at end March*, Reuters, 25 April 2014.

[16] Center for American Progress and Workers Rights Consortium, *Global Wage Trends for Apparel Workers, 2001–2011* (2013). http://cdn.americanprogress.org/wp-content/uploads/2013/07/RealWageStudy-3.pdf (accessed on 30 June 2014).

[17] French National Contact Point for Implementation of the OECD Guidelines for Multinational Enterprises, *French NCP Report on Implementation of the OECD Guidelines in the Textile and Clothing Sector* (2013). http://www.uscib.org/docs/2014_04_15_CR_Committee_FrenchNCP.pdf (accessed on 30 June 2014).

[18] ILO Constitution (1919).

Human Rights.[19] In the wake of several high-profile garment factory accidents in recent years, the global media, non-governmental organizations (NGOs), labor unions, consumer groups and other stakeholders have focused attention on the working conditions, including low wages, of garment workers in many parts of the world.

For example, the Clean Clothes Campaign has national campaigns in 16 European countries, with a network of 250 organizations worldwide, and calls for clothing brands and companies to adopt concrete, measurable steps throughout their supply chain to ensure garment workers are paid a living wage. The Asia Floor Wage Alliance, an alliance of trade unions and labor-rights activists, is similarly focused on securing a regional decent wage for garment manufacturing workers. These and other groups measure industry efforts to progress a living wage, including whether companies: endorse the principle of a living wage in their company policy and supplier code; adopt a code of conduct incorporating the human rights in the Universal Declaration of Human Rights and ILO's labor standards; and respect freedom of association and collective bargaining.[20]

Many retailers have committed to addressing wages and other human rights impacts in sourcing markets as part of their compliance and corporate social responsibility (CSR) functions. Companies have also joined global and local initiatives (e.g., Better Work, the UN Global Compact, the Better Cotton Initiative and the Sustainable Apparel Coalition) to discuss standards and benchmarks with companies, NGOs, academia and others.

In addition to brand risk, wage-related conflicts have the potential to disrupt operations and companies' supply chains. In recent years, countries such as Bangladesh, China and Haiti have all experienced labor unrest, including strikes, street confrontations with police and burned factories. The number of strikes in Cambodia jumped 170 percent between 2010 and 2012, according to Better Factories Cambodia (BFC), a nonprofit organization that monitors the garment industry.[21] Against this backdrop, industry companies should closely monitor the legal, economic and political climate in the relevant countries on labor issues such as the minimum wage, and adopt a coordinated, integrated approach to global labor and supply chain issues.

C. Hours of Work

Like wages, limits on hours of work are addressed by international human rights standards, as well as most countries' laws. ILO standards on working time address hours of work, daily and weekly rest periods, night and part-time work, and paid annual holidays, among other issues.[22] The laws of most jurisdictions similarly cover working hour limits, overtime, rest periods, annual leave, public holidays, and shift and part-time work. Scheduling employees to comply with working time laws, while managing costs and satisfying consumer preferences – which traditionally require non-standard working hours – can be a significant challenge for industry employers.

[19] Article 23 of the United Nations Universal Declaration of Human Rights (1948).
[20] http://www.cleanclothes.org/
[21] Kingdom of Cambodia, et. al, *Thirtieth Synthesis Report on Working Conditions in Cambodia's Garment Sector* (2013).
[22] International Labour Standards on Working Time, available at http://www.ilo.org/global/standards/subjects-covered-by-international-labour-standards/working-time/lang--en/index.htm

Many countries limit the number of hours an employee can work before higher "overtime" wage payments apply (usually on a daily, weekly and/or annual basis).[23] Standard working hours are generally between 40 and 44 per week; however, these vary around the world. Working time laws can also limit overtime hours, to set a maximum working day, week and/or year. In, e.g., France, the maximum number of hours that an employee may actually work per day is limited to 10 and cannot exceed 13 (i.e., including working time and breaks), except in certain specific cases. In contrast, Hong Kong law does not impose maximum working hours, and there is no statutory overtime pay. Employers can elect to offer overtime at their discretion. However, employers in Hong Kong are required by the Employment Ordinance to provide one statutory rest day in every period of seven days.

If an employee needs to work overtime (subject to maximum working hours limits), the employer must pay "overtime" higher wages as required by law. The amount of overtime pay can vary, based on whether overtime hours are worked on a normal working day, or on a weekly rest day, public holiday or annual leave day. Many jurisdictions have strong protections for weekends and holidays and permit work only in certain circumstances. In other countries, such as the U.S., employers are not automatically required to pay overtime for weekend or holiday work if the total hours worked in the work week do not exceed the maximum working hours.

In some jurisdictions, determining "hours worked" for the calculation of overtime pay can be difficult. For example, in the U.S., activities that an employee engages in before or after the employee's regular workday are considered compensable hours worked "if those activities are an integral and indispensable part of the principal activities".[24] This standard has been applied to donning and doffing protective clothing, travel time to or from a customer site, and preparatory and postliminary activities. In the most recent case to reach the U.S. Supreme Court involving retail shipping clerks, the court held that time spent waiting for and undergoing post-shift bag checks as part of security screenings was not compensable because the security screenings were not integral and indispensable to the job duties of boxing and shipping packages to customers.

In addition to statutory limits, collective agreements can play a significant role in determining working hours and overtime payments. In many countries, employers must discuss working hours, as well as any proposed changes in agreed working hours, with the works council or employees' representatives before announcing and implementing them. In, e.g., Japan, employers may require employees to work overtime or on holidays if they have entered into an agreement regarding overtime (*saburoku kyotei*) with a labor union representing a majority of employees, or, where no such union exists, an employee representative of a majority of employees.

Many industry employers utilize shiftwork and other flexible working time arrangements, such as part-time employment. The types of arrangements and the flexibility available to employers vary by jurisdiction. In, e.g., China, regulations provide for a standard working hours system, under which employees should not work more than eight hours per day and 40 hours per week. However, Chinese law also provides for alternative working hours systems. Upon government approval, an employer may institute the Comprehensive Working Hours System, under which employers may require employees to work longer hours without paying for overtime, so long as the average hours worked in a certain period does not exceed the limit on total hours for

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[23] ILO Working Conditions Laws Database, available at http://www.ilo.org/dyn/travail.
[24] *Integrity Staffing Solutions v. Busk*, 134 S.Ct. 1490 (2014).

that period (in which case, overtime compensation must be paid); or the Flexible Working Hours System, under which employers may require certain staff (as specified by People's Republic of China law), such as high-ranking managerial staff and sales staff, to work in excess of 40 hours per week without paying overtime compensation.

Efforts are underway in some jurisdictions to limit "just in time" or "on-call" employment. In, e.g., the U.S., retailers are under increasing pressure from some workers, unions, advocacy groups and lawmakers to provide workers with more predictable hours, extra pay for on-call work, and minimum notice of a work schedule. Cities and states are also taking action. San Francisco, e.g., recently passed the Retail Workers Bill of Rights Ordinance to address scheduling practices by retailers, including fashion retailers, effective in 2015. The ordinance regulates schedule changes, mandatory on-call pay, protections for workers after a sale of business, and requiring covered employers to offer more hours to existing part-time employees before hiring additional part-time workers.

D. Exemptions

In many jurisdictions, certain categories of employees are "exempt" from minimum wage and/or overtime pay requirements, meaning the laws do not apply to them. Qualifications for these exemptions typically take into account the duties the employee primarily performs, the employee's compensation (such as whether the employee is salaried or highly paid) and the employer's industry. Some exemptions apply solely to overtime pay requirements, others to both the minimum wage and overtime pay requirements.

Analyzing whether or not employees are properly classified as exempt or non-exempt under legal standards can be difficult, increasing wage and hour risk. The tests for determining whether an employee is exempt or non-exempt are often fact-intensive, and the penalties for misclassification can be significant. Employers can be liable for unpaid back wages, overtime compensation, liquidated damages, attorney's fees and court costs, and civil and criminal penalties. Moreover, it is common for employers to misclassify a group of workers in the same position or who are performing similar tasks, increasing the risk of employee lawsuits and, in certain jurisdictions, class actions. Accordingly, employers should carefully review exemption classifications to ensure all legal requirements are met.

Analyzing exemptions is particularly challenging in some jurisdictions. For example, in U.S., certain categories of employees are exempt from the overtime pay provisions of the FLSA, as well as state wage/hour laws. Commissioned sales employees of retail and service establishments are exempt from overtime pay requirements under the FLSA, if more than half of the employee's earnings come from commissions and the employee averages at least one-and-a-half times the minimum wage for each hour worked. State law exemption requirements for commissioned sales employees can differ.

Industry employers must also comply with federal and state laws governing the payment of commissioned employees. Under the FLSA, the most common issues are calculation of "regular rate" and payment of overtime to such commissioned employees. State law provides another layer of laws for commissioned employees, including timing of commission payments, contract requirements, forfeiture prohibitions, and commissions due when there are customer returns or non-payment. For example, in California, the employer must provide employees paid on commission with a written contract that sets forth the method by which the commission shall be computed and paid and obtain a signed receipt for it. Depending on the employee's exemption classification, commissioned employees may also need to receive a certain amount of commissions each pay period under California law.

Other federal exemptions to overtime and minimum wage requirements are the "white collar" exemptions, which are applicable to employees holding executive, administrative and professional positions, as defined by federal regulations. Qualifications for various exemptions typically take into account the duties the employee primarily performs, the employee's compensation and the employer's industry.

Misclassification of employees as exempt managers is a particular challenge for retailers in the U.S. Under the executive exemption duties test, the "primary" duty of the employee must be management of the store or a customarily recognized department or subdivision of the store. While this requirement can be met without the employee spending the majority of his or her work hours on management, management responsibilities (e.g., interviewing, hiring, training, assigning work, evaluating employees' performance) must be the most important duties the employee performs. In addition, the employee must customarily and regularly direct the work of at least two or more other full-time employees (or their equivalent). Some states have adopted a quantitative approach to determining the executive exemption. To qualify as exempt in, e.g., California, the employee must spend more than half of his or her time performing exempt managerial duties.

In March 2014, President Obama signed a presidential memorandum directing the Department of Labor to update the regulations defining "white-collar" exemptions from minimum wage and overtime requirements under the FLSA. While the Wage and Hour Division (WHD) has not yet issued the proposed regulations, employers expect revisions to the duties that must be performed by an employee to qualify for a particular exemption, as well as salary requirements.

E. Enforcement

While many garment-producing countries have made progress in the regulation of wages, maximum working hours, and overtime payments, non-compliance is the norm in many developing economies and differences in enforcement can be substantial. The enforcement measures taken to ensure the effective application of wage and hour laws – labor inspection, court and/or administrative penalties for non-compliance – and means to recover unpaid amounts vary from country to country.

In some countries, such as the U.S., wage and hour disputes are a common source of employment liability facing industry employers. Lawsuits typically allege employees were misclassified as exempt from overtime requirements, misclassified as independent contractors, not paid for all hours worked, not provided with required rest and/or meal breaks, or performed activities during breaks or before or after a shift that should be compensable. To minimize wage and hour risk, employers should regularly review their pay practices, in view of the most commonly litigated activities and the various jurisdiction-specific requirements.

The increase in wage and hour cases in the U.S., many of which are filed as class or collective actions, is primarily due to the relative ease with which claims can be brought under the FLSA and the statutory entitlement to attorneys' fees on either a settlement or judgment in favor of plaintiff employees. Under the FLSA's liquidated damages provision, employees can recover double the wages owed for two years prior to the filing of the lawsuit and any continuing violation period – or three years when it is determined that the employer's violation was "willful" – plus attorneys' fees and interest. Some states, such as New York, allow for recovery of up to six years of back wages. In addition, plaintiffs' attorneys frequently target policies or practices applicable to a large group of employees, from a single facility to a nationwide class, resulting in significant exposure.

Agency enforcement activity is also on the rise in certain jurisdictions. In recent years, the U.S. Department of Labor has targeted the garment industry in Southern California as part of its enforcement initiative to end "sweatshop conditions". According to the WHD, over the past five years, its offices in Los Angeles, San Diego and West Covina have conducted more than 1,500 investigations of garment industry employers in Southern California. The Department of Labor is also focused on combating contractor misclassification. Approximately 239 Labor Department wage theft investigations involved garment industry employers during the last fiscal year.[25] Accordingly, employers should review all independent contractor classifications to minimize employment, benefit and tax liabilities.

V. Health and Safety

A. Overview

Various international instruments set forth the basic principle that workers should be protected from sickness, disease and injury arising from their employment. ILO Convention 155 on Occupational Safety and Health outlines action to be taken by governments and within companies to promote occupational safety and health and to improve working conditions. Most countries also have a national occupational health and safety (OHS) regulatory framework. Yet, millions of workers die each year from work-related accidents and diseases. The ILO has estimated that 4 percent of the world's annual gross domestic product (GDP) is lost as a consequence of occupational diseases and accidents.

The types of risks facing industry employees vary depending on the type of work and conditions. In textile manufacturing, unsafe buildings and exposure to cotton dust, chemicals and noise can be significant issues. On the retail side, common risks include slips and falls; injuries from manual handling and moving displays, racks, fixtures and fittings; and stress from repetitive movements.

Industry companies must also address health and safety issues in their supply chains. The collapse of Rana Plaza in Bangladesh highlighted the poor safety and working conditions in some garment industry facilities around the world. In the wake of Rana Plaza, garment brands, governments, unions and other social partners have sought to respond in a unified way to the challenge of making factories in the supply chain safer. The resulting agreements, including the Accord on Fire and Building Safety in Bangladesh (the Accord) and the Alliance for Bangladesh Worker Safety, and factory inspection programs represent a plan to establish a safe ready-made garment industry in Bangladesh. In addition, many retailers and fashion brands have committed to

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[25] Tiffany Hsu and Chris Kirkham, *Southern California is hotbed for wage theft in garment industry*, *LA Times* (15 November 2014), accessed at http://www.latimes.com/business/la-fi-wage-theft-20141114-story.html#page=1.

addressing human rights impacts, including in relation to worker health and safety, in sourcing markets as part of their compliance and CSR functions.

B. OHS Regulatory Framework

National OHS legislation and regulations in most countries require employers to protect the health and safety of workers.[26] While the OHS legal and regulatory framework varies by jurisdiction, in general, employers are responsible for adopting protective measures, including providing workers with necessary protective equipment; providing workers with appropriate OHS information and training on workplace hazards; maintaining records and/or reporting work-related accidents and illnesses; designating an expert, committee or other structure to support health and safety activities; and/or complying with all OHS standards. Employees are generally responsible for following instructions given for their own health and safety, as well as taking reasonable steps to protect the health and safety of co-workers.

In, e.g., the U.S., the federal Occupational Safety and Health Act of 1970 (OSH Act) requires employers to: (i) provide employees with safety training programs and information regarding the safety considerations associated with the various components of their jobs; (ii) maintain a workplace free of hazards; and (iii) maintain accurate records of work-related injuries and illnesses.

In Peru, employers are responsible for introducing a safety and health system that includes a prevention plan; providing workers with necessary protective gear; providing information about workplace hazards, and health and safety training and recommendations; maintaining records of work-related accidents and risks; reporting workplace fatalities; having an internal safety and health regulation if there are 20 or more employees; and establishing an OHS committee or supervisor.

Employers in Mexico must observe OHS provisions set forth in article 123 of the Constitution of Mexico, the Federal Regulation on Occupational Safety and Hygiene and the Working Environment, the Federal Labour Law, the Mexican Law of Metrology and Normalization, and a number of Official Mexican Standards regulating particular OHS issues, such as standards for the organization of safety and health committees.[27] Employers must also adopt adequate safety and health measures to prevent accidents and diseases and address workplace hazards, inform workers about risks and provide personal protective equipment, and keep documentation and records related to training and incidents. In addition, in workplaces with 100 or more workers, the employer must perform a risk assessment of safety conditions and establish a written OHS program.

In many countries, workers have the right to participate in workplace health and safety activities. In Canada, for example, joint health and safety committees composed of management and worker representatives act as an advisory body, identifying hazards and recommending corrective actions to management. Provincial health and safety laws set guidelines for organizing the committee, the structure of the committee, meeting frequency, and the roles and responsibilities of committee members. Employers in Colombia with more than 10 employees

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[26] ILO Global Database on Occupational Safety and Health Legislation (LEGOSH). ILO, Geneva.
[27] *Id.*

must implement a health and industrial safety regulation, and create a security and health in the workplace program and committee.[28] In Japan, an employer must appoint a certain type of manager and/or committee in accordance with its category and size of business. Failure to fulfill this obligation may result in a fine of up to JPY500,000.

C. Industry OHS Regulations

Many jurisdictions have enacted laws that are particularly relevant to industry employers. For example, for manufacturers in the U.S., general industry OHS standards address issues of exposure for employees who participate in a variety of activities involved with making finished apparel and footwear (e.g., sewing, cutting, gluing and stitching). These include chemical exposure from the processing and dyeing of materials, exposure to cotton and other organic dusts, musculoskeletal stresses, heat and noise exposure, and hazardous machinery. OHS standards similarly protect workers from a wide range of hazards associated with weaving, synthesizing, compounding and other ways of producing textiles, leather or other starting products. These standards limit the amount of hazardous chemicals workers can be exposed to, require the use of certain safe practices and equipment, and require employers to monitor certain workplace hazards.

In California, the Garment Manufacturing Act requires every business that engages in garment manufacturing activities such as sewing, cutting, making, processing, repairing, finishing, assembling, or otherwise preparing any garment, to register with the Labor Commissioner. It is illegal for a registered business to hire others to manufacture garments unless they are registered. Similarly, New York law requires garment industry manufacturers and contractors to register with the New York State Department of Labor.

In China, the Interim Provisions on Administration and Supervision of Work Safety in Confined Spaces at Industrial and Trading Enterprises provide additional work safety requirements for companies in the textile industry that conduct clothing manufacturing in confined spaces.

Different safety issues are implicated on the retail side. For example, the Occupational Safety and Health Administration (OSHA) encourages U.S. employers to adopt effective safety and health management systems to identify and eliminate work-related hazards caused by large crowds at sales events. Fashion retailers planning a large shopping or promotional event should adopt a plan that considers issues such as staffing, the use of trained security, training, public safety requirements, necessary permits and licenses, crowd management methods and communications.

D. Common Law

In addition to statutory duties, in many countries, employers have a duty to take reasonable care to avoid exposing employees to reasonably foreseeable risks of injury. An employer can also owe a common law duty of care to persons other than its employees in relation to its business activities and premises. An employer may be vicariously liable for injuries, loss or damage caused by the negligence of an employee, if the employee’s conduct was in the course of employment or reasonably incidental to the employee’s employment.

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[28] *Id.*

E. Enforcement

While most countries have adopted OHS laws and regulations, enforcement varies from jurisdiction to jurisdiction. In addition, many workers are part of the informal economy and outside health and safety protections. While the enforcement risk in some countries is relatively low, companies in violation of health and safety laws can be subject to significant fines and penalties, criminal prosecution, and even closure of facilities under certain terms and conditions. Industry companies also face increased supply chain and reputational risks based on health and safety issues.

In the U.S., OSHA is responsible for enforcing health and safety standards at more than 7 million worksites across the nation. An employee has the right to complain to both OSHA and his or her employer about any possible workplace hazards. The OSH Act prohibits an employer from discriminating or retaliating against an employee for exercising rights under the statute.[29] Protected rights include filing an OSHA complaint, participating in an inspection, seeking access to employer exposure and injury records, and raising a safety or health complaint with the employer. Failure to comply with rules, regulations and standards enforced by OSHA expose an employer to significant costs, including penalties, litigation and civil liability.[30] Employers and managers may also be subject to criminal prosecution for willful violations of OSHA standards and state laws.

In Canada, provincial health and safety acts make it an offense to violate legislative provisions. In, e.g., Ontario, every person who fails to comply with a provision of the act or the regulations, an order or requirement of an inspector or a director, or an order of the minister, is guilty of an offense and, on conviction, is liable to a fine of not more than C$25,000 or to imprisonment for a term of not more than 12 months, or to both. If a corporation is convicted of an offense, the maximum fine that may be imposed upon it is C$500,000. In some serious cases, charges may also be laid by police or crown attorneys under the Canada Criminal Code.[31] Penalties include a range of sentencing options, e.g., imprisonment and fines.

In some Latin American countries, enforcement has also become, or is becoming, more common and stronger. For example, in Colombia, the Ministry of Labour, through its Labor Risk Department, is empowered to perform investigations of occupational accidents that have occurred within companies, to impose sanctions on employers that breach their health and safety obligations, and to enact programs or policies that employers must comply with at the workplace. Recently, the department has been significantly proactive, investigating and sanctioning companies that do not comply with the policies and regulations regarding security and health at the workplace. The fines that the Ministry of Labour can impose on companies can equal 1000 minimum monthly statutory salaries,[32] and if the company repeats its non-compliant behavior, the ministry is entitled to order closure of the business for 120 days or on a permanent basis.

[29] 29 C.F.R. §24.102(a)
[30] Occupation Safety and Health Act (OSHA) of 1970, 29 U.S.C. § 651(a)-(d) & (i).
[31] Canadian Centre for Occupational Health and Safety, *Bill C-45 – Overview*, available at http://www.ccohs.ca/oshanswers/legisl/billc45.html (accessed on 2 July 2014).
[32] For year the 2014, the minimum monthly statutory salary was equivalent to COP616,000.

VI. Supply Chain

A. Overview

In a world of complex supply webs, migrant workers, labor agents, sub-suppliers, and a constant squeeze on costs, no industry or region is fully insulated from the risks associated with ever-expanding supply networks. Recently, the U.S. Department of Labor produced a list setting out 122 products or goods produced in 58 countries using forced labor, child labor, or both.[33] The items on this list include cotton, footwear, garments, leather, fashion accessories, textiles and gems.

Because global labor and product supply chains contain multiple levels of subcontracting, parent corporations are often immune from domestic legal accountability, given the extraterritorial nature of their supplier relationships and the arm's length nature of supplier contracts and subcontracts. Nevertheless, leading businesses understand the importance of pursuing long-term sustainable business strategies and fulfilling their obligations as global corporate citizens by working to combat this global problem. The fundamental principles that are guiding corporate leaders in pursuing reform and action in this area are found, most prominently, in the UN Guiding Principles on Business and Human Rights.[34] The UN Guiding Principles make clear that corporations have a responsibility to respect human rights by taking steps to prevent abuses and to remedy infringements.

Companies are taking proactive steps to operationalize their social expectations by embracing human rights due diligence procedures and implementing remedial action plans, particularly in the area of trafficking and forced labor. A recent report, jointly released by the American Bar Association, the School of Politics and Global Studies and the McCain Institute of Arizona State University, indicates that 54 percent of Fortune 100 companies have policies targeting human trafficking and 68 percent have a commitment to supply chain monitoring, with most using a mixture of internal and external monitoring methods.[35] More than 60 percent also express a commitment to providing training for staff and supply chain vendors.[36] When operating in countries with weak enforcement regimes and ineffective central or local governments, corporations understand that they must be vigilant to ensure that they are not benefiting from or taking advantage of a vacuum of proper regulatory authority.

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[33] United States Department of Labor, 2013 List of Goods Produced by Child or Forced Labour (Report required by the Trafficking Victims Protection Reauthorization Act) <http://www.dol.gov/ilab/reports/pdf/2013TVPRA_Infographic.pdf> accessed 12 October 2014.

[34] UN Human Rights Council, Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect, Remedy Framework", U.N. Doc A/HRC/17/31 (21 March 2011) (the "U.N. Guiding Principles") <http://www.ohchr.org/Documents/Issues/Business/A-HRC-17-31_AEV.pdf> accessed 2 May 2014.

[35] American Bar Association and Arizona State University, *How Do Fortune 100 Corporations Address Potential Links to Human Rights Violations in a Globally Integrated Economy*, 2 June 2014.

[36] *Ibid*.

B. Regulatory and Legal Regimes

At the UN and the ILO level, and at the national and regional level, legislators and policy-makers are actively seeking regulatory mechanisms focused on corporate practices.[37]

In the US, in recognition of both the magnitude of global human trafficking and forced labor, and the fact that the US federal government is one of the world's largest procurers of goods, President Obama recently signed Executive Order 13627[38] prohibiting U.S. federal contractors and subcontractors from their own misleading or fraudulent recruitment practices, charging employees recruitment fees, destroying, concealing, confiscating or denying access to employee identity documents, and failing to pay for return transportation costs upon the end of non-U.S. employment. The Executive Order also requires that any federal contractor and subcontractor permit access to audits by the U.S. contracting agencies. For those U.S. federal contracts and subcontracts for not off-the-shelf products where more than US$500,000 is performed outside the U.S. borders, the Executive Order further requires the creation of an "awareness program" to prevent subcontractors at any tier from engaging in trafficking of persons, and requires the contractor's monitoring, detection and termination of any subcontractor who has engaged in such activity.

In the U.S., the states are also becoming more active. California, e.g., enacted legislation focused on corporate transparency, the California Transparency in Supply Chains Act of 2010 (CTSCA). The CTSCA came into force on 1 January 2012 as a first-in-the-world effort to combat forced labor and human trafficking through corporate supply chain disclosure requirements and consumer awareness efforts.[39] It is important to highlight the reach of the CTSCA. California's size, and the fact that it is the world's ninth-largest economy, ensures that a significant number of the world's global manufacturing and retail companies are captured by the law. Following California's lead, other jurisdictions have considered similar measures, including the U.S. federal government, the British parliament, and the EU.[40]

The CTSCA applies to companies (a) doing business in the state of California with more than US$100 million in annual worldwide gross receipts; and (b) that list either retail sales or manufacturing as their principal business activity on their corporate tax return.

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[37] See, International Labour Organization, Forced Labour Convention, C29 (28 June 1930); *UN Expert Meeting on Trafficking in Persons, Human Trafficking & Global Supply Chains: Background Paper* (12 November 2012, Ankara, Turkey) 5 <http://www.ohchr.org/Documents/Issues/Trafficking/Consultation/2012/BackgroundPaper.pdf> accessed 27 May 2014; In 1998, ILO Convention 29 — which defines and prohibits forced labour — was identified by ILO as one of eight "core" Conventions, see <http://www.ilo.org/wcmsp5/groups/public/---ed_norm/---declaration/documents/publication/wcms_095895.pdf> accessed 12 April 2014.

[38] U.S. President Obama, Executive Order 13627 — Strengthening Protections Against Trafficking in Persons in Federal Contracts (25 September 2012).

[39] California Transparency in Supply Chains Act 2010, Cal Civil Code s 1714.43, SB 657 (2012).

[40] See, e.g., United States Business Transparency on Trafficking and Slavery Act, HR 2759 (112th); Transparency in UK Company Supply Chains (Eradication of Modern Slavery) Bill 2012–13; UK Draft Modern Slavery Bill HC 1019, Session 2013-14; U.S. President Obama, Executive Order 13627 – Strengthening Protections Against Trafficking in Persons in Federal Contracts (25 September 2012); see also the UK announcement on 25 June 2014 that it will be producing recommendations to assist industry in eliminating human rights abuses in their supply chains <https://www.gov.uk/government/news/government-asks-retailers-to-lead-the-way-on-transparent-supply-chains> accessed 18 August 2014; EU Directive 2013/34/EU, requiring disclosure by public companies of non-financial information on policies, outcomes and risks relating to social matters, among other things.

It broadly defines "doing business" to include companies that, e.g., have California sales in excess of US$500,000; or have a California payroll exceeding US$50,000.

A company that meets this standard must disclose its efforts to eliminate forced labor and human trafficking from its direct supply chain for tangible goods offered for sale.

The required disclosure must be posted on the company's website with a conspicuous and easily understood link to the required disclosure information. The disclosure must, at a minimum, disclose to what extent, if any, the business does each of the following:

1. verifies product supply chains, to evaluate and address the risk of human trafficking and slavery (the disclosure must specify if the verification was conducted by a third party or not);
2. performs supplier audits, to evaluate compliance with company standards (the disclosure must specify if the verification was an independent, unannounced audit or not);
3. requires certification by direct suppliers that materials used in products comply with the laws regarding slavery and human trafficking of the country or countries in which they are doing business;
4. maintains internal accountability standards and procedures for employees or contractors that fail to meet company standards on slavery and trafficking; and
5. trains relevant company employees and management on trafficking and slavery, particularly concerning the mitigation of risk within supply chains.[41]

Although the impact of any new law takes time to assess fully, one is able to get an early picture of the CTSCA's effect by reviewing the first wave of corporate disclosures. Importantly, NGOs have begun assessing the information posted by companies in response to the law's requirements. One website (www.knowthechain.org) has been developed through a partnership between a number of civil society organizations, and provides a user-friendly search engine tool for the corporate disclosure reports arising under the CTSCA.

Using this tool, one can relatively easily review and compare disclosure reports for the companies captured by the law's requirements. A review of the CTSCA disclosures reveals that companies are responding to the law in one of five ways.

Some companies are embracing the requirements, by detailing the extensive policies and measures they have in place, highlighting their commitment to combating forced labor in their supply chain. Next, there are companies that have indicated that while they have not, to date, undertaken significant steps in this area, they are committed to taking action going forward. There are then the corporate disclosures that merely track the language of the law and indicate compliance without providing any supporting statements or referencing any specific steps being undertaken. Fourth, there are companies that disclose they are taking no steps to identify or eradicate human trafficking or forced labor from their supply chains.[42] And, finally, there continue to be companies that are simply unaware of the CTSCA or their obligation to provide disclosures regarding whether or not they take the enumerated steps to eradicate human trafficking and slavery.

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[41] For further discussion, see Cynthia Jackson, "California Requires Supply Chain Disclosure", [2011] *The Recorder*, November 2011.
[42] Jonathan Todres, "The Private Sector's Pivotal Role in Combating Human Trafficking" [2012] *Cal L Rev* Circ vol 3, 88.

C. Codes of Conducts and Contracts

Beyond complying with the law, companies are increasingly implementing and updating enterprise risk management systems and programs into their supply chains. Many companies require contractual and other measures that allow for close monitoring, regular audits and reporting, with a specific focus on eliminating the potential for trafficking and forced labor to arise within their extended enterprise.

Many companies include supply chain requirements within their codes of conduct and supplier contracts. These best practice contracts and codes are then required when a company enters into a contract with a supplier, ensuring that the company's expectations with regard to human trafficking and forced labor are clearly set out from the beginning of the relationship. Many companies' codes of conduct address issues such as minimum pay, decent working conditions, and human trafficking in its supply chains. For example, some companies sign the Code of Conduct for the Protection of Children from Sexual Exploitation in Travel and Tourism 2004, and incorporate the anti-trafficking language into their code of business ethics, suppliers code of conduct, and directly into their supplier contracts. In addition, some corporations are also providing training to their suppliers and employees to raise awareness, and ensure that their employees and suppliers understand the various red flags, both generally and those that are specific to industries and regions. Other companies conduct audits of suppliers in all countries, with a specific focus on exposing trafficking and forced labor.

VII. Immigration

A. General Overview

Immigration laws, like other laws, differ from country to country. Although the specific names for visas and the requirements differ, there are common patterns and trends – especially for countries balancing the interests of engaging in global commerce against protecting local labor markets and national security.

Treaties and bilateral agreements often give special privileges to citizens from specific countries (e.g., benefits for EU and European Economic Area (EEA) citizens; and benefits for citizens of Canada, Mexico and the U.S. under the North American Free Trade Agreement).

B. Business Travel

1. Visitor Visas

Multinational corporations routinely have employees visiting colleagues and customers in different countries. How easily this can be accomplished often depends as much on the passport carried by the employee as it does on the country being visited. The length of the trip and the scope of activities undertaken can be key, with visa solutions for short trips under 90 days being generally more readily available.

Travel for tourism and for short-term business visits is often authorized by the same visa. But that is generally true only when the scope of the intended business activity does not rise to the level of productive employment in the country being visited.

Sourcing compensation locally during the visit is routinely prohibited, but the focus usually extends beyond the duration of the trip or the source of wages. Visiting customers, attending meetings and negotiating contracts are commonly permitted. Providing training and handling installation or post-sales service are frequently prohibited.

2. Visa Waiver

Many countries have provisions that waive the normal visa requirement for tourists and short-term business visitors. These visa-waiver benefits tend to be reciprocal and are limited to citizens of specific countries (i.e., those that extend similar benefits to local citizens). Additional requirements (e.g., departure ticket) are sometimes imposed. Further, the countries that enjoy visa-waiver privileges frequently change, making it important to check for updated information with a country's consular post before making travel arrangements.

3. Training

Companies with experienced staff in one country invariably want to bring newer staff from abroad for training. This is especially true when the research and development work happens in one country, the manufacturing in another, post-sales installation and support is handled by regional centers, and the ultimate users are spread around the world.

Many countries (e.g., Brazil and Japan) offer specific visas designed for training assignments. Some of these authorize on-the-job training that involves productive work. Others are limited to classroom-type training and limit or prohibit productive work. Visas designed for employment assignments can often be used in training situations, if on-the-job training involving productive work is desired and not otherwise permitted by a pure training visa.

C. Employment Assignments

Visas for employment assignments are invariably authorized, but the specific requirements vary widely.

1. Work Permits

Most countries are keen to protect their local labor market. A recurring solution is to impose some kind of labor market check as a prerequisite to issuance of a visa for an employment assignment (e.g., in Malaysia). These are often handled by a Ministry of Labor or equivalent government labor agency, as distinct from the Foreign Affairs governmental agency that issues visas at consular posts. In many countries, the labor agency's authority is framed in the context of a work permit.

A work permit or equivalent document is a requirement generally imposed for employment assignments. But it is also common for countries (e.g., Belgium) to have visas that are exempted from the work permit requirement. The number of exemptions greatly exceeds the general rule.

Just who is exempted depends on the country. Most countries exempt employees being transferred within multinational companies, as well as business investors and high-level/key employees. Education, especially higher-level education in sought-after fields, can often be used to qualify for employment assignments. Academic transcripts showing completed studies are frequently required. Letters verifying employment experience can be similarly useful.

Additionally, workers from EU Member States who are seeking work in a second EU state are often exempt from work permit and/or visa requirements, and must simply register their residence upon entering the country.

2. Residence Permits

Concern over national security has become increasingly common. Background clearance checks, and the collection of biometric data for identification purposes, is common today. But a number of countries have long addressed this concern with a reporting requirement. Sometimes this is done in the form of a residence permit, usually handled by a ministry of justice, ministry of the interior, or equivalent agency. In other cases, or in combination with the above, there is a requirement to report to local police authorities after arrival in the country (e.g., France and Italy). These requirements are every bit as important in maintaining the status to lawfully live and work abroad as obtaining the proper visa.

D. Industry-specific Travel Needs

1. Buying and Merchandising

Purchasing goods and materials is generally an acceptable activity for a business traveler, whether admitted into the relevant country on a business visa or with a visa-free status. However, when embarking on purchasing trips, buyers should be aware of the time limits on business travel, which vary from country to country. For example, business visitors to the U.S. are typically admitted for no more than six months at a time, and business visitors to the UK are limited to a maximum of six months in any 12-month period. Business visitors to France and Italy may stay for a maximum of 90 days in a 180-day period.

While business visitors to any country should always confirm that the activities they plan to perform while in the country comply with the applicable business visa regulations, one can generally presume that work is not permitted while holding visitor status. Again, while the definition of what constitutes work may vary from country to country, business visitors are generally prohibited from engaging in gainful employment in the foreign country, and generally may not receive compensation from an entity within the visited country or sign contracts on behalf of such an entity. The following activities are generally acceptable as a business visitor: (i) engaging in commercial transactions that do not involve gainful employment in the visited country (such as a merchant who takes orders for goods manufactured abroad); (ii) negotiating contracts on behalf of an entity abroad; and (iii) consulting with business associates.

Also applicable to the industry, while purchasing goods and materials is acceptable, further work on the materials – such as designing, sewing or manufacturing clothing – would likely be considered work and therefore prohibited without a work permit.

2. Manufacturing

As mentioned in the previous section, manufacturing is generally prohibited without a work permit, and the eligibility criteria and processes for obtaining a work permit vary widely from country to country. Certain countries, such as the U.S., do not have a work visa category for non-professional positions, with very few exceptions. Typically, a work permit requires a petition by an in-country employer.

Many countries offer a visa category specifically for foreign-owned companies that establish operations or engage in other significant international trade or investment activities – such as a manufacturing facility – in the country. Most countries then allow such companies to transfer existing employees to the new entity to facilitate the new enterprise, assist with training a new workforce, and perform work, among other things.

The unavailability of visas for non-professional positions in the fashion industry – such as garment workers – has been a source of discontent in the U.S. in recent years, and many noted designers and fashion houses, such as Diane von Fürstenberg and Oscar de la Renta, have been vocal in their support for U.S. immigration reform that would provide legal status for such workers.

3. Fashion Design and Modeling

While many work visas require the offer of a professional position and the attainment of at least a bachelor's degree or its equivalent, certain countries, including the U.S., make specific exceptions for fashion models. For example, the H-1B visa, a U.S. work visa available for "specialty occupations", specifically exempts fashion models of distinguished merit and ability from the category's prerequisite for a bachelor's degree. All other applicants for the visa category must provide evidence of attainment of the minimum of a baccalaureate degree or its equivalent. The UK also has a visa category that allows fashion models to enter for up to one month at a time to participate in a specific paid assignment.

Fashion designers are more likely to fall under the category of a professional position, and many may hold the requisite baccalaureate degrees that will ease the process of obtaining a work permit in most countries.

Chapter 12: International Trade and Customs Issues for the Luxury and Fashion Industry[1]

I. Introduction and Overview

The luxury and fashion industry shares the same basic customs issues and challenges as most other industries. However, for decades, companies in the luxury and fashion industry have been the major focus of the customs authorities in the United States (now Customs and Border Protection (CBP)) and elsewhere. There are several reasons for this. First, in most countries, luxury and fashion goods (particularly textiles, wearing apparel, footwear, accessories and watches) have some of the highest duty rates imposed on imported goods and materials. This fact alone places luxury and fashion goods at the top of Customs' priority list.

Second, those luxury and fashion industry companies engaged in global tax planning must consider the customs implications of their strategy. As a general rule, strategies intended to reduce global taxation can and often do increase customs duty liability. Thus, in any tax-planning exercise customs laws and rules should be taken into account in order to make sure that the desired results are achieved. In addition, at least in the United States, there may be ways to reduce tax liability without adversely affecting customs duty assessment, or even reducing customs duty liability, as will be discussed herein.

Third, the defining elements of the luxury and fashion industry, namely intellectual property (IP) such as, brand equity and marketing intangibles, create customs issues in the valuation of imported goods, to the extent payments are made for these rights. The "brand" is an extremely valuable asset that, in some manner, must be taken into account in the pricing of goods in cross-border transactions, or separately through royalties, licensing fees, service agreements, etc. All of these raise significant customs issues (both legal and practical), as customs values are declared at the time of the importation of the goods, usually well before any subsequent payment or price adjustments due to these other factors.

Fourth, many luxury and fashion industry companies have to deal with other laws enforced by customs authorities. Specifically, restrictions on the trade in endangered species by the U.S. Fish and Wildlife Service has a significant impact on the luxury and fashion industry, particularly at the high end. In addition, most of the 50 states have their own rules about the acquisition and marketing of products containing species (which may or may not be restricted under international conventions). Not surprisingly, California leads the list. California also has Proposition 65, which allows class action suits to be filed by citizens against the sale and distribution of products containing certain controlled species, or made with materials that, according to California

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standards, can be a danger to humans or the environment. For example, at the time of writing, a class action suit has been filed against several major apparel and accessory companies and retailers for labeling their goods “Made in USA” when, according to the class action plaintiffs, the goods do not meet the stringent qualifications of that designation. If true, this could also be a violation of the Lanham Act for false advertising but the class action aspect of California Proposition 65 is a potent weapon that is difficult to defend.

Fifth, classification rules can be complex when it comes to wearing apparel, footwear and accessories, particularly where designers create garments that blur lines between traditional categories or gender, or use new combinations of fabrics in their construction.

Sixth, a central element of customs jurisprudence is country-of-origin marking and the use of free trade agreements. Because the manufacture of many luxury and fashion goods is labor intensive, it is tempting to consider production in developing countries that are subject to the numerous free trade agreements that the U.S. and other countries have entered into. These agreements, however, create challenges, as the enforcement of the rules of origin is vigorous and the compliance rate (post-audit) is surprisingly low. This is normally not intentional but, rather, due to numerous factors such as changes in standard costs, changes in other production costs, unfamiliarity with the complex origin rules, unreliability of factory data. The result can be, and often is, the denial of the duty-free status well after the importation of the goods, along with the assessment of interest and possible penalties.

Seventh, the area of “assists” is extremely problematic for the luxury and fashion industry. Oftentimes, what distinguishes a brand is its design and designers. From the U.S. standpoint, design work performed outside the U.S. must be added to the dutiable value of imported merchandize to the extent it is not already included in the price. This is a global issue because the value of the design work should be allocated among the countries in which the goods are distributed, such that the impact can affect every country in which a company’s goods are sold.

Eighth, at the high end of the luxury and fashion industry, the use of temporary importations under bond (TIBs) and carnets is prevalent for trunk shows, etc. The rules here are very strict, as all of the goods must be returned and then re-entered (duty-paid) prior to sale. The assessment of liquidated damages (often equal to the value of the entire shipment) is a frequent and costly event.

Last, a core concern of the luxury and fashion industry is counterfeit and gray market goods. Here, Customs can be an ally, in detaining and ultimately seizing counterfeit goods and even gray market goods if the trademark is both owned by a U.S. corporation or individual and registered with CBP. While enforcement may be difficult, the seizure of an importation (particularly for seasonal merchandise) can be a powerful weapon and creates an alliance between CBP and the companies owning the brands.

As will be seen, all of these issues, and more, create a challenging environment for companies in the luxury and fashion industry.

II. Customs Valuation

A. General Introductory Comments

Establishing the correct value for imported goods is a critical component of responsible importing, because that value is the basis for duty calculation in most cases.[2] However, many importers, and especially multinational companies (MNCs), are often unaware of the rules for customs valuation, and assume that if a price is acceptable for tax transfer pricing purposes, then it must also work for customs purposes. This false logic is why many companies find themselves facing substantial, and often unexpected, bills for duty, fines and penalties.

Under U.S. customs law, importers are responsible for exercising reasonable care in determining the value of their imported merchandise. In related party transactions, reliance on sound tax structure does not always mean compliance with customs rules. The opposite is more often the case. There are numerous differences between valuation for transfer pricing purposes and customs valuation. Unlike for transfer pricing purposes, Customs has transaction-based reporting, which makes it difficult to price particular goods (samples, prototypes, etc.) and report price changes, such as transfer price adjustments. Moreover, the use of standard costs, or other costs subject to change, can lead to problems with customs compliance. Even unrelated party transactions cause problems, due to failure to take into account indirect payments (e.g., distributorship fees) and assists (e.g., design work performed outside the U.S.).

The challenges importers face in reconciling the differences between tax and customs rules are particularly problematic for MNCs. And, while efforts have been made to harmonize tax and customs valuation systems, this goal seems a long way off, in large part because of the different standards of "arm's length" pricing and the methods of dealing with price adjustments. Unless and until harmonization is reached, importers and MNCs, and those who advise them, should be familiar with both valuation systems and the differences between them.

B. The Basics of Customs Valuation – an Introduction to the U.S. Statute

Duties are generally levied on an *ad valorem* basis, meaning that the rate of duty is stated as a percentage of the value of the imported merchandise. Accordingly, before any duty can be assessed, CBP must first determine the value of the imported goods. For some goods, the value is relatively easy to discern. Other goods, however, require the application of a more complex valuation method for the purposes of duty assessment.

Like all of the World Trade Organization (WTO) countries, the U.S. has adopted the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade (1994) (the WTO Customs Valuation Agreement) and modified it slightly through its own legislation. Merchandise imported into the U.S. is appraised for customs purposes in accordance with section 402 of the Tariff Act of 1930, as amended by the Trade Agreements Act of 1979 (19 U.S.C. § 1401a) and its implementing regulations under 19 C.F.R. § 152.

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[2] Valuation is relevant to those goods classified under *ad valorem* provisions of the tariff where the duties are all calculated as a percentage of value, and also for goods subject to free trade agreements and certain other provisions. These provisions cover the vast majority of all goods imported into the U.S., including luxury and fashion goods.

C. Hierarchy of Valuation Methods

Unlike transfer price methodologies and their “best method” approach, the U.S. customs law provides a strict hierarchy of appraisal methods. The preferred formulation of all merchandise exported to the U.S. is the “transaction value” for the goods.[3] Indeed, in the vast majority of cases, transaction value is the basis used. However, if transaction value cannot be used, then the rules provide certain secondary bases of value, including the following, listed in order of preference

1. Transaction Value of Identical or Similar Merchandise

Transaction values of “identical”[4] and “similar”[5] merchandise are narrowly defined, and importers and customs authorities usually lack the information necessary to use these methods of valuation. As a result, transaction values of “identical” and “similar” merchandise are almost never used, particularly when we consider how the value of the brand differentiates luxury and fashion goods – e.g., is a $100 woolen sweater “similar” to a $1,000 woolen sweater made by a couture company?

- If a transaction value for the imported goods is not available, the importer may use the transaction value of identical merchandise, sold for export to the same country of importation, and exported at or about the same time as the goods being valued.[6]
- If there is no acceptable transaction value for identical merchandise, or if no identical merchandise exists, then the importer should consider whether there is an acceptable transaction value for similar merchandise, sold for export to the same country of importation, and exported at or about the same time as the goods being valued.[7]
- The transaction value of identical or similar merchandise must be based on actual sales, at the same commercial level and of substantially the same merchandise being appraised.[8]

2. Deductive Value[9]

Deductive value is rarely used as a method of appraisal because it is extremely complex and difficult to apply. By definition, the information required for deductive value is not available at the time of import, and importers and CBP generally lack the information necessary to use deductive value.

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[3] 19 U.S.C. § 1401a(a)(1).

[4] For merchandise to be “identical”, it must meet stringent criteria. In the U.S., “identical” merchandise must be (i) identical in all respects to the merchandise being appraised; (ii) produced in the same country as the merchandise being appraised; (iii) produced by the same person as the merchandise being appraised. 19 U.S.C. § 1401a (H) (2). If merchandise does not meet at least the first two criteria, it will not qualify as identical merchandise.

[5] The criteria for merchandise to be “similar” are also quite stringent. Under U.S. customs law, for merchandise to be “similar”, it must be: (i) produced in the same country and by the same person as the merchandise being appraised; (ii) like the merchandise being appraised in characteristics and component materials; and (iii) commercially interchangeable with the merchandise being appraised. 19 U.S.C. § 1401a(h)(4). If there is no merchandise meeting all three criteria, then “similar merchandise” may be merchandise produced by a different entity, provided it has the same country of production, like characteristics and component materials, and commercial interchangeability.

[6] 19 U.S.C. § 1401a(c)(1); see also article 2 of the WTO Customs Valuation Agreement.

[7] 19 U.S.C. § 1401a(c)(1); see also article 3 of the WTO Customs Valuation Agreement.

[8] 19 U.S.C. § 1401a(c)(2); see also article 2(1) (b) and 3 (1) (b) of the WTO Customs Valuation Agreement.

[9] The order of precedence of the deductive and computed values may be reversed at the time of entry. 19 U.S.C. § 1401a (2).

- Deductive value is generally calculated by starting with the resale price of either past importations of the good being valued, or the resale price of identical or similar goods that are resold in the condition as imported, and then deducting profit and general expenses (and other costs) to arrive at a value at the point of importation.[10]
- Among other things, deductive value allows for deductions for "any commission usually paid or agreed to be paid, or the additions usually made for profit and general expenses, in connection with sale in the United States of imported merchandise that is of the same class or kind".[11] Here, "same class or kind" includes merchandise imported from the same country as well as other countries as the merchandise being appraised.[12]
- Importantly, the deduction for profits and general expenses means that an importer may deduct the markup added for resale in the country of importation and instead use the "unit price" at the point of importation (e.g., the FOB (FOB) or Free Carrier (FCA) price).[13]

3. Computed Value

Computed value is generally the best alternative to transaction value because it is less complex than the other alternatives, and the information required is often more readily available to the importer (but not to CBP). However, importers may still have difficulty using computed value because factories (even if they are related) may not wish to provide the necessary costing information. Also, like deductive value, there may be difficulties applying the concept of "same class or kind". In the luxury and fashion industry, this concept is particularly hard to apply, as, e.g., a "woolen suit" may cost $100 or $5,000, making any comparison useless even though one could argue that it is the same "class or kind of merchandise".

- Computed value consists of the sum of (i) the value or cost of materials, fabrication, and other processing used in producing the imported merchandise; (ii) profit and general expenses; (iii) any other assists; and (iv) packing costs.[14]
- The cost or value of the materials component of computed value consists of the actual figures relating to the production of the imported merchandise: i.e., standard costs cannot be used.
- The usual profit and general expenses component of computed value is limited to the "narrowest group or range of imports" for what is usual for sales of the "same class or kind" of goods being imported from the same country as the merchandise being appraised.[15]

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[10] 19 U.S.C. § 1401a(d).
[11] 19 U.S.C. § 1401a(d) (3) (A).
[12] 19 C.F.R. § 152.105(b). The concept of "same class or kind" is narrow and difficult to apply.
[13] 19 U.S.C. § 1401a (d).
[14] 19 U.S.C. § 1401a (e) (1); see also article 6 of the WTO Customs Valuation Agreement.
[15] 19 C.F.R. § 152.106 (e); see also article 15 (3) of the WTO Customs Valuation Agreement. While "class or kind" is a broader concept than "identical or similar", it is still relatively narrow and may cause problems for importers who are unable to obtain the necessary information to establish same "class or kind". Both concepts are much narrower than the comparables used in tax studies.

4. Residual Value ("Fall-back Method")

The residual value method is only a last resort and CBP must first approve the method before an importer can use it.

- If none of the above five methods can be used to appraise the imported merchandise, and if customs agrees, then the importer may use a "residual" method, meaning that the value is derived from one of the five methods, reasonably adjusted as necessary.[16]
- The basis for appraisal for the residual value must be reasonable and cannot be: (i) the selling price in the U.S. of merchandise produced in the U.S.; (ii) a system that provides for the appraisal of imported merchandise at the higher of two alternative values; (iii) the price of merchandise in the domestic market of the country of exportation; (iv) the cost of production, other than computed value for merchandise that is identical merchandise or similar merchandise to the merchandise being appraised; (v) minimum values for appraisal; or (vi) arbitrary or fictitious values.[17] [18]

Theoretically, all bases of appraisal should result in the same valuation, the only difference being the way in which the result is reached. Practically, however, the resulting values often differ, depending upon the method of valuation used.

5. Transaction Value Defined

Transaction value is by far the most common basis of appraisal, and it is the only basis that creates a nexus with transfer pricing. All of the other bases discussed above are developed using alternative data sources. "Transaction value" means the price actually paid or payable for the merchandise when sold for exportation to the U.S., plus certain limited adjustments and subject to certain restrictions, particularly as to related party transactions.[19] 19 U.S.C. § 1401a(b)(4) provides:

> The term "price paid or payable" means the total payment (whether direct or indirect, and exclusive of any costs, charges, or expenses incurred for transportation, insurance, and related services incident to the international shipment of the merchandise from the country of exportation to the place of importation in the United States) made, or to be made, for imported merchandise by the buyer to, or for the benefit of, the seller.

In other words, the transaction value is the total amount the buyer pays the seller for the goods, either directly or indirectly, excluding insurance, international freight, and other cost, insurance and freight (C.I.F.) charges. Thus, the U.S. law is distinguished from other countries, as it establishes the basis of valuation at the point of shipment, rather than destination.

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[16] 19 U.S.C. § 1401a (f) (1); see also article 7 (1) of the WTO Customs Valuation Agreement.
[17] 19 U.S.C. § 1401a(f)(2); see also article 7(2) of the WTO Customs Valuation Agreement.
[18] For example, the basis for customs valuation could be the transaction value of identical or similar merchandise produced in a country other than the country of exportation of the merchandise being appraised. Alternatively, an importer may use deductive or computed values of identical or similar merchandise. For an example of the rejection of transaction value and other bases of appraisement in favor of residual value, see US Ruling HQ 008101 (9 October 2012).
[19] 19 U.S.C. § 1401a(b)(1). Article 1 of the WTO Customs Valuation Agreement also provides that "transaction value" is the primary basis of appraisement for imported goods for customs purposes: The customs value of imported goods shall be the transaction value: i.e., the price actually paid or payable for the goods when sold for export to the country of importation adjusted in accordance with the provisions of article 8.

Example 1

Company A, a Hong Kong company, sells merchandise to Company B, a U.S. company, which plans to resell the merchandise in its retail stores in the U.S. The transaction value under this scenario would be the cash value that Company B pays to Company A in exchange for the merchandise.

Example 2

If Company B reduces the prices on a current importation to settle a debt that Company A owes to Company B, the amount of reduction in price would also be included in the transaction value, as an indirect payment.

In addition to the price paid or payable, certain other amounts must be included in the transaction value of the imported merchandise. In particular, indirect payments, such as payments to suppliers, related companies, or other parties, for services related to imported merchandise, e.g., royalties, service fees, design fees or promotional fees, are frequently required additions to the "price paid or payable". Companies must be especially careful about any payments made to parties related to the seller.

19 U.S.C. § 1401a(b)(1) provides that an importer must add to the price paid or payable amounts equal to:

- the packing costs incurred by the buyer with respect to the imported merchandise;
- any selling commission incurred by the buyer with respect to the imported merchandise;
- the value, apportioned as appropriate, of any assist;
- any royalty or license fee related to the imported merchandise that the buyer is required to pay, directly or indirectly, as a condition of the sale of the imported merchandise for exportation to the U.S.;
- the proceeds of any subsequent resale, disposal or use of the imported merchandise that accrue, directly or indirectly, to the seller.[20]

However, none of the above amounts should be added if they have already been considered in determining the price paid or payable.[21]

- Packing costs: packing costs include any cost incurred by the buyer for all containers and coverings of whatever nature and for the labor and materials used in packing the imported merchandise for export, if not already included in the price. This issue rarely comes up and is usually straightforward.
- Selling commissions: whether payments made to an agent are added to the "price paid or payable" depends primarily upon which party (the seller or the buyer) controls the activities of the agent. Any commission paid to the seller's agent, who is related to, or controlled by, or works for or on behalf of, the manufacturer or the seller, must be added to the "price paid or payable" for the imported merchandise. In contrast, commissions paid by the buyer to its own agent are not added to the "price paid or payable".[22] This use of agents in the luxury and fashion industry is common, and it is essential to know whether the company being used as an "agent" is under the control of the seller (a selling

[20] See also article 8 of the WTO Customs Valuation Agreement.
[21] 19 U.S.C. § 1401a(b)(1).
[22] Although buying agency commissions are not dutiable, U.S. customs law requires that they be disclosed to Customs. See, e.g., US Ruling HQ 544965 (February 22, 1994).

commission that could be dutiable), the buyer (a buying commission that is not dutiable if properly structured and documented), or an independent contractor that acts as a reseller on its own account, in which case the applicable sale may be from the "agent" to the importer (see the first sale discussion below). Even "bona fide" buying commissions can be held to be dutiable if paid through the seller, as there is no statutory provision that would allow for a deduction from the price paid.

- Assists: the concept of "assists" is relatively new to customs valuation and can be difficult in application. Assists are tangible items given by the buyer to the seller, directly or indirectly, which the seller would otherwise have to purchase to make the goods.[23] The assumption is that if the "assist" is given without charge to the seller (or at reduced cost), then the price of the finished good will be less than it would be without the assist. Assists include the following:
  - materials, components, parts and similar items incorporated in the imported merchandise (e.g., fabric or trim);
  - tools, dies, molds and similar items used in producing the imported merchandise (e.g., molds used for forming the soles of shoes or sewing machines); [24]
  - merchandise consumed in producing the imported merchandise (e.g., under certain circumstances, at least in the U.S., fabric waste created during the cutting process), i.e., once production has begun;[25] and
  - engineering, development, artwork, design work, and plans and sketches that are undertaken outside the U.S. (e.g., design work, which, in the case of luxury and fashion goods, can represent a significant portion of the value of the "brand").

The value of an assist includes either (i) the cost of acquiring the assist, if acquired by the importer from an unrelated seller; or (ii) the cost of the assist, if produced by the importer or a person related to the importer. Any costs for transporting the assist to the place of production are also added to the value. Generally, the value of an assist is further adjusted to reflect appreciation or depreciation in the value that results from use, repairs, modifications or other factors affecting the value of the assists.[26]

After the value of an assist has been determined, the next step is to prorate that value to the imported merchandise. Often the value of an assist is not attributable to one particular imported item but, rather, to a series of goods for which the assist was used in production. For example, the entire cost of acquiring a loom for the production of fabric should not be included in the value of only one roll of fabric produced on the loom, unless there is a sound business reason for doing so: e.g., the goods are duty free. Otherwise, the assist could be apportioned among all rolls of fabric produced on that loom, including fabric not exported to the U.S. Accordingly, the value of an assist is apportioned in "a reasonable manner appropriate to the circumstances and in accordance with generally accepted accounting principles".

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[23] 19 U.S.C. § 1401a(h)(1)(A).
[24] For an example of tooling payments (rather than the tooling itself) being considered as an assist, see US Ruling HQ H134595 (31 July 2012).
[25] 29 Cust. B & Dec. 51 (20 December 1995, effective 29 January 1996).
[26] While no ruling or case specifically addresses this issue, it would appear that "research" performed outside the U.S. is not included as an assist, while product development is so included. Note also that design work performed outside the U.S. that is merely conceptual in nature and not necessary for the production of the imported goods may not be considered a dutiable assist: US Ruling HQ H206976 (17 August 2012).

By way of example, if the design budget of a luxury or fashion company is $10,000,000, the following types of adjustments can be made: Assume that:

1. 30% of the designs never enter the production stage;
2. of the goods produced using the designs, only 50% enter the U.S.; and
3. the value of the designs allocated to U.S. imports would be $10,000,000-$3,000,000-$3,500,000 or $3,500,000.

This amount can then be apportioned in a rational manner over goods with differing duty rates.

- Royalties and license fees: royalties and license fees are the least understood and most problematic area of customs valuation in the U.S. and elsewhere. The key issue, whether a royalty is related to the goods and a condition of the sale, has not been clearly addressed in the U.S., which causes enormous confusion, particularly as royalties and license fees are common in the luxury and fashion industry.
- The U.S. generally requires importers to include royalties and license fees in the amount paid or payable for imported merchandise. To be included in the transaction value, the royalty or license fee must be: (i) related to the imported goods; and (ii) paid as a condition of sale of the imported goods. Although both requirements must be met for the royalty or license fee to be included in transaction value, "there is also a close economic connection between these requirements".[27][28] Accordingly, whether a particular royalty or license fee is dutiable depends largely on the individual circumstances under which the fee was paid. The treatment of royalties and other intangibles under U.S. customs law is discussed in more detail later in this chapter.
- Proceeds of any subsequent resale, disposal or use of the imported merchandise that accrue to the seller: in addition to the royalties provision discussed above, 19 U.S.C. § 1401a(b)(E) contains a separate "subsequent proceeds" provision, which requires the addition to transaction value of "the value of any part of the proceeds of any subsequent resale, disposal or use of the imported goods that accrues directly or indirectly to the seller",[29] provided the proceeds are not otherwise included in the price paid or payable.[30] [31]

The distinction between the "royalty' and "subsequent proceeds" provision is confusing and complex, as royalties are, by nature, structured as a "subsequent proceed". One obvious distinction is that a subsequent proceed must be paid to the seller, whereas a royalty can be paid to the seller, a party related to the seller or a third party. Moreover, arguably, the difference between the royalties provision and the subsequent proceeds provision is that one is meant to cover intangibles,

[27] 19 C.F.R. 152.103(e).

[28] 19 U.S.C. § 1401a(b)(1) (D). Also, the Interpretative Notes to article 8, paragraph 1 (c) of the WTO Customs Valuation Agreement provides that: '[p]ayments made by the buyer for the right to distribute or resell the imported goods shall not be added to the price actually paid or payable for the imported goods if such payments are not a condition of the sale for export to the country of importation of the imported goods'.

[29] Saul Sherman and Heinrich Glashoff, 'Customs Valuation: A Commentary on the GATT Customs Valuation Code' (1988), p. 123.

[30] See also article 8.1(d) of the WTO Customs Valuation Agreement.

[31] For example, Company A, a French parent, sells goods to Company B, its U.S. subsidiary. If, after importation into the U.S., Company B transfers to Company A a portion of the proceeds from Company B's sale of the merchandise it purchased from Company A, then company B may also be required to add those proceeds to the transaction value of the imported merchandise.

i.e., patents, copyrights, trademarks, distribution rights, etc., whereas the other is intended to cover the proceeds from the resale or use of tangible imported goods. Thus, it can be argued that where a royalty is paid for an intangible right, it should not be dutiable as a proceed of subsequent resale or use under 19 U.S.C. § 1401a(b)(E). However, customs authorities in many countries, including the U.S., do not take this position.

The royalties and subsequent proceeds provisions are frequently analyzed and applied without distinction. The point of confusion between the two is due to the fact that royalty payments are frequently expressed as a percentage of the proceeds of the resale of the tangible good. Subsequent proceeds apply not only to the proceeds of resale of the good, but also to the proceeds derived from subsequent use of the good. Therefore, it may be in the best interest of the importer to move away from transaction value, if possible, and use one of the alternative methods of valuation. In every case, when drafting royalty, licensing, distributorship and other agreements, companies should be careful to ensure that the language of those agreements does not inadvertently give rise to dutiability of payments for intangibles as royalties or subsequent proceeds. Careful drafting of the agreements can help to prevent the exposure that is often created once Customs becomes aware of these “indirect payments”.[32]

- Certain amounts can be excluded from transaction value. These include:
  - the cost, charges or expenses incurred for transportation, insurance and related services incidental to the international shipment of the goods from the country of exportation to the place of importation in the U.S.;
  - any reasonable cost or charges incurred for constructing, erecting, assembling, maintaining or providing technical assistance with respect to the goods after importation into the U.S., or for transporting the goods after importation; and
  - the customs duties and other federal taxes, including any federal excise tax, for which sellers in the U.S. are ordinarily liable.[33]

Post-importation adjustments can also be made as an allowance for defective merchandise if appropriate procedures are followed.[34]

When is transaction value not the proper method?

While transaction value is the preferred method of appraisal, if any of the limitations discussed below are present, then transaction value cannot be used, and the next basis of value will be considered in the order of the hierarchy discussed above.[35]

There are four different types of limitations on the use of transaction value:

- restrictions on the disposition or use of the merchandise;
- conditions for which a value cannot be determined;[36]
- proceeds of any subsequent resale, disposal or use of the merchandise, accruing to the seller, for which an appropriate adjustment to transaction value cannot be made; and
- related party transactions where the transaction value is not acceptable.

[32] See, e.g., General Notice, Dutiability of Royalty Payments, 27 Cust. B & Dec., p. 1 (10 February 1993) (Hasbro II ruling).
[33] 19 U.S.C. § 1401a(b) (3).
[34] 19 C.F.R. § 158.12. See HQ H014663 (13 February 2008).
[35] 19 U.S.C. § 1401a(a)(1); see also General Introductory Commentary to the WTO Customs Valuation Agreement, paragraph 1.
[36] An example would be “tie-in” sales, where the purchase or price of one imported article is conditional upon the purchase or price of another. This could easily lead to importers negotiating high prices for low duty rate goods and vice versa.

The most common limitation is that applicable to related party transactions. U.S. customs law provides two tests for what constitutes an "acceptable" transaction value in a related party transaction where the price cannot be assumed to be arm's length. (These tests are discussed in more detail in the following sections.)

From a customs perspective, there are several advantages to the use of transaction value. Because the customs law requires an importer to value its goods under transaction value (unless transaction value cannot be determined), customs authorities favor the use of transaction value. And, in practical terms, transaction value tends to be more predictable and easy to apply because it is normally based on the invoice price. However, to use transaction value, companies must first deal with the hurdles listed above, particularly those involved with related party pricing.

D. Interaction between Transfer Pricing and Customs Valuation

Many MNCs assume that if their intercompany pricing works for transfer pricing tax purposes, then it will work for customs. In addition, many MNCs seek to use their transfer prices as the basis for customs valuation. However, the use of their transfer prices for customs purposes generally leads to the following major issues:

- having to justify transfer prices under the distinct customs and transfer pricing methodologies and arm's length tests;
- dealing with the impact that retroactive transfer pricing adjustments have on declared customs values;
- transfer pricing fluctuations due to the application of the CPM or other operating income approaches; and
- acknowledging that a transfer pricing documentation study is generally an overall verification that the aggregate of the transactions reflect an arm's length result that may not establish the custom value of specific goods.

U.S. Customs is not fluent in tax law or language, and MNCs should be careful when attempting to use a transfer pricing documentation study or advance pricing agreement (APA) to validate a related party price for use as the customs value for duty calculation. Many MNCs with transfer pricing policies based on relevant tax rules have argued that compliance with tax standards satisfies the relevant arm's length standards for customs valuation. Yet, distinct methods must be used to verify the same transaction for transfer pricing and customs purposes, and the arm's length analysis result may be different and irreconcilable. The mere fact that tax allows an aggregation of products and product lines, and Customs looks to the value of each product within a product line, is sufficient conceptually to alert one to the fact that such differences preclude matching analyses.

In its early rulings, CBP took the position that tax data was irrelevant for customs purposes. More recently, however, U.S. Customs has indicated that it will consider certain tax data in analyzing the price for customs purposes, but that transfer pricing documentation by itself is generally insufficient to establish proper valuation for customs purposes.[37] For example, in its

[37] For example, in HQ H032883 (31 March 31 2010), U.S. Customs stated that it will consider APAs relevant where U.S. Customs "participated in the APA pre-filing conference between the importer and the IRS". But U.S. Customs did not elaborate further as to what it means for it to have "participated". See also HQ H029658 (8 December 2009).

recent publications, CBP has taken the following positions on the use of these studies and APAs for customs purposes:

> [A]n APA or transfer pricing study by itself is not sufficient to show that a related party transaction value is an acceptable transaction value.
>
> The importer must provide information and evidence regarding the circumstances of sale and/or test values. [i.e., rules unique to customs valuation, as discussed above.]
>
> An importer that relies solely on an APA or transfer pricing study to conclude that transaction value is acceptable would not be exercising reasonable care.

Moreover, according to U.S. Customs:

> an APA or transfer pricing study would not ordinarily establish the normal pricing practices of the industry for purposes of determining whether the price was settled in a manner consistent with the normal pricing practices of the industry in question under the circumstances of sale test.[38]

U.S. Customs has allowed importers to rely on transfer pricing studies or APAs to support customs valuation in the rare situations where the tax data pertained to the same class or kind of merchandise being imported.[39] For the majority of MNCs, however, the comparables used for tax purposes will not meet the U.S. Customs criteria for "same class or kind", and thus cannot be relied upon for customs purposes. Given that most MNCs have nothing but tax data to support the customs value, the lack of sufficient comparables for U.S. Customs purposes can be problematic.

Accordingly, transfer pricing that is designed with a primary focus on business objectives and tax rules geared to confirm or validate an overall result may still create serious difficulties, if used for customs valuation purposes. We, therefore, recommend that MNCs prepare a customs valuation study, either as part of an APA or as a separate undertaking, that uses the same data as the tax study but attempts to connect more closely the relevant factors for U.S. Customs purposes.

The rationale for the distinctions between transfer pricing and customs valuations must be kept in mind. First and foremost are the philosophical and practical differences between the goals of tax and customs authorities. Customs duties are applied based on the value of goods at the time of entry into the U.S. Customs imposes a duty at the goods classification level, including component parts, and requires a detailed transaction-by-transaction approach. In contrast, the taxing authorities normally start their transfer pricing review with gross income, and determine taxable income after appropriate deductions. These rules seek to allocate income between related parties to achieve an overall reflection of income and to prevent the shifting of income between tax jurisdictions. These determinations may take place years after the date the goods entered the U.S. and were classified and valued for customs purposes.

Second, both transfer pricing and customs valuation seek an "arm's length result". For tax, this analysis may be on a class or aggregation of products or product lines, whereas Customs looks at its classification and valuation on a transaction-by-transaction basis. In the tax area, not only may there be this aggregation, but there may be offsetting or periodic adjustments all geared to achieve an overall arm's length result for the legal entity. A typical transfer pricing study prepared

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[38] See HQ 547672 (21 May 2002); see also HQ H008706 (12 January 2010) (rejecting downward price adjustment to customs value where importer failed to present IRS transfer pricing information).

[39] See HQ H037375 (11 December 112009) (holding that transfer pricing study using RPM and applying comparables based on resale of goods of same class or kind as imported goods is evidence that price was settled "in a manner consistent with the normal pricing practices of the industry in question").

for the section 6662(e) documentation requirements may use the CPM approach to establish that the transfer pricing policy for all intercompany transactions achieved an arm's length result, because the tested party's operating profit fell within an arm's length profit range, but this study is likely to be irrelevant for the transaction-by-transaction approach taken by Customs at the time the goods entered the U.S.

Compounding the differences are the uses, noted above, of the transfer pricing approach where the actual transfer price becomes a "plug" number calculated to achieve a result that falls within a range of profit that would be considered to be earned by a similarly situated company. Not only does this method create an overall transfer price for all products (rather than on a transaction-by-transaction basis), but the determined transfer price may change within the taxable year as a result of periodic adjustments that may be necessary to assure an arm's length result and, for that matter, may change from year to year as the comparable sample of companies used to comprise the range of profit changes, due to their financial performance results. CBP, on the other hand, requires a determination of a particular product value at the time of entry, and its rules restrict an importer's ability to make adjustments.

Finally, the luxury and fashion industry is by definition a leader in style changes and developments. This alone makes it difficult to extrapolate a reliable customs value from the aggregated tax data that is available.

E. Transaction Value and Transfer Pricing – the Legal Standard

As we have seen, one of the most common reasons why transaction value may be inappropriate for customs purposes is because the transaction involves related parties, and the price cannot be supported adequately under the customs rules. CBP has two methods for validating transfer pricing under transaction value: (i) test values; and (ii) circumstances of the sale.[40]

- Test value: in a related party transaction, the transaction value is acceptable if it closely approximates a "test value" that relates to merchandise exported to the U.S. at or about the same time as the imported merchandise. The possible "test values" include (i) the transaction value of identical merchandise or of similar merchandise in sales to unrelated buyers in the U.S.; and (ii) the deductive value or computed value for identical merchandise or similar merchandise.[41] For the purposes of testing for transaction value, the test values are for comparison only and do not form a substitute basis of valuation.

To determine whether the transaction value closely approximates one of the foregoing test values, adjustment may be made if the sales involved differ in commercial levels, quantity levels, the costs, commission, values, fees and proceeds added to the transaction value (price paid) if not included in the price, or the costs incurred by the seller in sales in which he or she and the buyer are not related that are not incurred by the seller in sales in which he or she and the buyer are related.[42]

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[40] 19 U.S.C. § 1401a(b) (2) (B).
[41] Id.
[42] 19 U.S.C. § 1401a(b)(2)(C).

In the U.S., an actual appraisal using one of the test values must be considered by U.S. Customs[43]. This rarely happens. As a result, the test value method test is of limited utility.

- Circumstances of the sale: the "circumstances of the sale" (COS) test examines all of the facts surrounding the transaction giving rise to importation of the subject merchandise, to determine whether the relationship between the parties affected the price paid or payable. In other words, the COS test looks at the way in which the price was arrived at, to determine whether the relationship influenced the price. For example, if the price had been settled in a manner consistent with the normal pricing practices of the industry in question, or with the way the seller settles prices for sales to buyers who are not related to him or her, this would demonstrate that the price had not been influenced by the relationship. Similarly, if the price is adequate to ensure recovery of all costs, plus a profit that is representative of the firm's overall profit realized over a representative period of time (e.g., on an annual basis) in sales of goods of the same class or kind, this would likewise demonstrate that the price had not been influenced by the relationship.[44]

Like the test value method, application of the COS test has its own inherent difficulties due to its subjectivity (e.g., what constitutes the "same class or kind" of goods) and its failure to rely on the type of comparables used for tax purposes.

F. Customs Valuation Issues Specific to Transfer Pricing

Customs valuations rarely arise in transfer pricing cases, whether at audit or in litigation. The reason is that, as stated above, while the respective methods appear similar, customs and tax have fundamentally different goals. During audit, the Internal Revenue Service (IRS) has occasionally sought customs data and clarifications, but experience has shown this to be impractical in many cases.

The transfer pricing valuation issues that arise in the context of customs frequently involve the following:

- use of transaction value and sustaining the "arm's length" standard for customs purposes;
- "indirect payments", e.g., royalties, designs and other service fees; and
- retroactive price adjustments.

G. Transaction Value and the "Arm's Length" Standard

The COS test is inherently subjective and difficult to apply, but a careful application of this test is critical to ensuring that the transaction value is proper. The same holds true for transfer pricing's comparability standards. Transaction value is the preferred method of valuation largely because of its predictability and ease of application. The same applies to the comparable uncontrolled price (CUP) method, where the requisite data is available.

Transaction value may have other benefits. For example, some MNCs who use transaction value may be able to structure their transactions to take advantage of the duty-saving strategy called the "first sale" structure. U.S. customs law permits appraisal of imports in multi-tiered sales

[43] 19 C.F.R. § 152.103(l)(2).
[44] 19 C.F.R. § 152.103(l)(1).

(e.g., manufacturer to distributor to U.S. importer), based on the “first sale” value (i.e., the sale from the manufacturer to the distributor). However, this “first sale” value can only be used if that sale, among other things, is a valid basis for transaction value. Thus, a careful application of the COS test is particularly important for those companies who wish to use the “first sale’ strategy. Where the first sale involves related parties, the transaction value will not be available unless the importer can demonstrate that the first sale meets the COS test (or test value standard). Whether an importer is able to use the “first sale” value as the basis of appraisal for customs valuation can make a significant difference to the amount of duty ultimately assessed. For example, the insertion of a middleman into a direct sale between a factory and the importer that is done for tax purposes may result in an increase of customs duties (based on the second sale) if (i) the goods are dutiable; and (ii) the “first sale” strategy is not implemented. Even for non-dutiable goods, the increased basis could result in significant additional import fees, as it may affect the goods’ qualification under free trade agreements. Therefore, it is important that any company seeking to use the “first sale” value as the basis for customs valuation examines the relationship between all parties and assesses whether the COS test will be met. But “first sale” is not limited to MNCs; and, in the U.S., it has become a common strategy to obtain duty savings (see further discussion below)

H. Royalties, License Fees, Indirect Payments and other Intangibles

Transactions are frequently structured around intangibles such as patents, trademarks, copyrights and exclusive distributorships. For tax purposes, many MNCs will transfer intangible rights to a related third party. However, by stripping out intangibles from the manufacturer and distributor, as is often the case for tax purposes, the MNCs may be creating problems for customs valuation. Therefore, when structuring the allocation of intangibles among related companies, MNCs should always consider the customs implications. This is particularly true for a MNC that does business in a country where customs duties are significant for their products.

The U.S. treats most royalty payments as dutiable, and any royalty paid to the seller is generally treated as forming part of the price paid or payable for the imported merchandise. Similarly, if the royalty is paid to a party related to the seller, the onus is upon the importer to show that the payments were not related to the imported merchandise. Even royalties paid to unrelated sellers can be dutiable under the “condition of sale” language.

Under U.S. law,

> ... additions for royalties and license fees will be limited to those that the buyer is required to pay, directly or indirectly, as a condition of sale of the imported merchandise for exportation to the United States. Hence, royalties and license fees for patents covering processes to manufacture the imported merchandise will generally be dutiable.[45]

To assess the dutiability of royalty or license fee payments, U.S. Customs has established a three-part test.[46] The test consists of the following questions:

1. ***Was the imported merchandise manufactured under patent?***
2. ***Was the royalty involved in the production or sale of the imported merchandise?***
3. ***Could the importer buy the product without paying the fee?***

[45] See HQ H043478 (23 March 2009) and HQ H137455 (16 February 2012).
[46] Statement of Administrative Action, Trade Agreement Act of 1979, H.R. Doc. No. 153, 96 Cong., 1st Sess. pt. 2.

An affirmative answer to questions 1 and 2 and a negative answer to question 3 point to dutiability. It is the third question that gets to the heart of whether the royalty is paid as a "condition of the sale",[47] and demonstrating that a royalty payment is not a condition of the sale is not an easy task.

CBP generally examines each case individually and analyzes several factors to determine whether the royalty is dutiable.[48] Overall, the key factor in determining whether royalties or license fees are paid as a condition of sale of the imported goods is whether there is a "separability" of the purchase of the imported goods from the payment of the royalties for the rights being licensed.[49]

On the other hand, the note to Art. I to Annex I: Interpretative Notes to the WTO Customs Valuation Agreement provides:

> The price actually paid or payable refers to the price for the imported goods. Thus the flow of dividends or other payments from the buyer to the seller that do not relate to the imported goods are not part of the Customs value.

These provisions indicate that where a fee or payment between related parties is so far removed from the value of the merchandise itself, it should not be included in the transaction value. As such, the "separability" test appears to apply equally in determining whether a royalty payment is dutiable as a condition of the sale or, alternatively, as a subsequent proceed of later resale, disposal or use of the imported merchandise in the U.S.

This "separability" test makes practical sense, because not all payments made between a foreign subsidiary and its parent can or should be dutiable. However, the problem with this rule is that it provides no bright line for determining whether the relationship between the payment and the imported merchandise is sufficiently distant to exclude the payment from the transaction value. To feel confident in excluding such a payment from the transaction value in a transfer pricing scenario, one would need to show that the transfer price, without the payment, was the result of an arm's length transaction for the goods.[50]

I. Retroactive Price Adjustments and the Importance of Reconciliation

The U.S. customs laws do not allow importers to consider downward post-importation price adjustments, but do require disclosure of value adjustments that increase the value of the imported

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[47] See, e.g., HQ W563404 (3 March 2006) and HQ 548560 (3 September 2004). This test also appears in the General Notice, Dutiability of Royalty Payments, Vol. 27, Cust. B & Dec., p. 1 (10 February 1993) (Hasbro II ruling).

[48] U.S. Customs Ruling HQ W563404 (3 March 2006).

[49] The factors include: (i) the type of intellectual property right at issue (e.g., patents covering processes to manufacture the imported merchandise generally will be dutiable); (ii) the party to whom the royalty was paid (e.g., payments to the seller or a party related to the seller are more likely to be dutiable than are payments to an unrelated third party); (iii) whether the purchase of the imported merchandise and the payment of the royalties are inextricably intertwined (e.g., provisions in the same agreement for the purchase of the imported merchandise and the payment of the royalties; license agreements that refer to or provide for the sale of the imported merchandise, or require the buyer's purchase of the merchandise from the seller/licensor; termination of either the purchase or license agreement upon termination of the other, or termination of the purchase agreement due to the failure to pay the royalties); and (iv) payment of the royalties on each and every importation. US Customs Ruling HQ 548560 (3 September 2004) citing US Customs Ruling HQ 547148 (12 September 2002).

[50] See also Interpretative Notes on Customs Value in Annex 23 to the Community Customs Implementing Code (Regulation (EC) No. 2454/93).

goods.[51] To make the situation worse, and unlike the transfer pricing rules, CBP does not net the value of imports over a period of time. Instead, it looks at the value of each importation separately. As a result, when an MNC makes a net upward or downward adjustment, CBP requires the importer to separate out each upward or downward adjustment within the net sum of adjustments to determine how it affects the value of individual entries. This level of detail is not used in transfer pricing analyses.

Retroactive transfer price adjustments can become a major issue. In the U.S., transfer price adjustments can be handled through the reconciliation prototype, which is a unique method of declaring post-importation adjustments with Customs. Under the reconciliation prototype, importers are required to register with Customs before they can reconcile with Customs any transfer price or other price adjustments that have occurred over the course of a year or other acceptable period. Reconciliation can be done in such a way as allows for both upward and downward adjustments. It can also be done in a manner that only takes into account upward adjustments, e.g., where the adjustments are revenue neutral and compliance is the major concern.

A partial alternative to reconciliation is to make a prior disclosure and voluntary tender of duties. In the absence of reconciliation, this is the best way for importers to keep themselves compliant with customs laws and to avoid potential penalties by coming forward before Customs discovers the error. However, where an importer has a large number of adjustments, such disclosures may be impracticable. In this situation, use of the reconciliation prototype is key. (See also the discussion of section 1059A.)

Both of these vehicles are useful methods of handling retroactive price adjustments and exercising reasonable care for imports into the U.S. However, it is important to keep in mind that these methods of making retroactive price adjustments to customs value are not available in most jurisdictions outside the U.S.

J. Section 1059A – Another Nexus between Tax and Customs

The U.S. Congress established a nexus between tax and customs in 1986, when it enacted section 1059A in an effort to alleviate concerns about tax evasion by related parties who were reporting different values for customs and tax purposes for imported products. Section 1059A provides:

> If any property is imported into the United States in a transaction (directly or indirectly) between related persons (within the meaning of section 482), the amount of any costs – (1) which are taken into account in computing the basis or inventory cost of such property by the purchaser, and (2) which are also taken into account in computing the customs value of such property, shall not, for purposes of computing such basis or inventory cost for purposes of this chapter, be greater than the amount of such costs taken into account in computing such customs value.

On its face, section 1059A appears to align the values used for both tax and customs, by prohibiting an importer from claiming a higher tax basis for imported merchandise than it claims for customs purposes. However, the actual application of section 1059A is significantly more

[51] See HQ H077419 (5 April 2011); HQ H127377 (31 March 2011). Both rulings concern trademark royalty payments to unrelated third parties.

complicated, and any apparent similarities between the two systems veil important differences, particularly regarding timing. Indeed, the tax basis under section 1059A may differ from a customs value because of legitimate differences between the tax and customs valuation rules. For example, customs value may allow for decreases in imported values by freight charges; insurance charges; construction, assembly and technical assistances after importation; and any other amounts not included in the customs value that are appropriately included in the cost basis for income tax purposes.

An important example often exists when there is a transfer price adjustment. There the value declared to Customs at the time of import might well be different from the post-adjustment value.[52] If the tax value is adjusted downward, then section 1059A will do no damage because it acts as a cap on the IRS inventory basis. On the other hand, if the value is adjusted upward, then section 1059A can be problematic for the taxpayer because the tax basis would be limited to the value declared to Customs at the time of import, unless adjusted through the reconciliation prototype. (Note that for purposes of section 1059A, reconciliation has been accepted by the IRS as a means to change the customs value after the fact, as it delays liquidation. Voluntary disclosures, on the other hand, do not impact liquidation of the entries and therefore leave the importer exposed should a retroactive price increase occur, even if its is disclosed to Customs). As a result, the taxpayer may be forced to use the lower customs value as the inventory basis for tax purposes.

K. First Sale

The first sale strategy has become popular in the U.S. and, under the right circumstances, can lead to significant duty savings. It is based on case law and the interpretation by the U.S. Court of International Trade (CIT) of the transaction value definition.

1. Case law: Nissho Iwai and Synergy Cases

Nissho Iwai involved subway cars manufactured in Japan and imported into the U.S. for use in the New York subway system. The parties involved in negotiating the original contract (the master contract) were the N.Y. Metropolitan Transportation Authority (MTA), Nissho Iwai American Corp. (NIAC), Nissho Iwai Corp. (NIC, NIAC's parent company), and Kawasaki Heavy Industries, Ltd. (KHI). After the execution of the master contract, NIC negotiated a manufacturing contract with KHI for the production of the cars. Although many of the terms of that second contract were controlled by the master contract, the price (free on board (FOB) Kobe, Japan) was negotiated at arm's length.

On appeal before the U.S. Court of Appeals for the Federal Circuit ("CAFC"), the appellate court determined that if the manufacturer's price and the middleman's price each constituted a statutorily viable transaction value, "the rule is straightforward: the manufacturer's price, rather than the price from the middleman to the purchaser, is used as the basis for determining transaction value." *Nissho Iwai*, 982 F.2d at 509. In determining whether a factory sales price

[52] See HQ H022287 (30 December 30 2010) (rejecting argument that section 1059A requires adjustment to customs value to reflect downward adjustments made for tax purposes pursuant to a bilateral APA).

constitutes a statutorily viable transaction value, the court announced the following requirements. First, the factory sale must clearly be a sale for exportation to the U.S. Second, the sale between the factory and middleman must be negotiated at arm's length.

Similarly, in *Synergy Sport International, Ltd. v. United States*, 17 CIT 18 (1993), the CIT held that the price paid by the middleman/importer was the proper basis for the transaction value. The CIT applied the Nissho Iwai analysis to general merchandise imported into the U.S. pursuant to a three-tiered purchasing arrangement. Following the decisions in *Nissho Iwai* and *E.C. McAfee Co. v. United States*, 6 Fed. Cir. (T) 92, 842 F.2d 314 (Fed. Cir. 1988), the CIT held that where there are two statutorily viable sales, transaction value is to be derived from the sale between the manufacturer and middleman. See *Synergy*, 17 CIT at 21.

The main players in Synergy were J.C. Penney (the U.S. customer), Synergy (the middleman/importer), and Chinatex (the overseas manufacturer). Prior to production of the imported pants, Chinatex and Synergy had entered into a "sales confirmation agreement", whereby Chinatex agreed to manufacture 17,000 pairs of cotton twill pants for Synergy at a cost of $58 to $61 per dozen, depending on the quality. J.C. Penney thereafter approached Synergy, provided it with a sample pant, and inquired whether Synergy could source the garment to J.C. Penney specifications. At Synergy's request, Chinatex produced a production sample of the J.C. Penney garment. After seeing the sample, J.C. Penney placed an order with Synergy for 2,044 dozen pants at $123.48/dozen. Synergy then opened a letter of credit to Chinatex, directing its bank to pay Chinatex $58/dozen for production of the J.C. Penney garments.

At trial, Synergy argued that the proper basis of appraisement was the price it paid to the manufacturer, Chinatex. Customs maintained that the imported wearing apparel should be appraised on the price paid by J.C. Penney to Synergy, as this was the sale that "most directly caused" the goods to be exported to the U.S.

Following the analytical approach of *Nissho Iwai*, the CIT examined the circumstances of sale between Chinatex and Synergy, and concluded that the sale was negotiated at arm's length. In finding that this sale was a "sale for exportation to the U.S.", the CIT relied upon two facts. First, the garments were manufactured with J.C. Penney labels, which specified the ultimate U.S. purchaser of the garments. Second, the merchandise was shipped directly from the manufacturer to the U.S.

An importer may therefore declare the price between the middleman and the manufacturer as the transaction value of imports when both sales, i.e., the first sale between the middleman and the manufacturer, and the second sale between the middleman and the U.S. customer, produce an accepted transaction value. *Nissho Iwai*, 982 F.2d at 509 (holding that when "both the manufacturer's price and the middleman's price are statutorily viable transaction values, the rule is straightforward: the manufacturer's price, rather than the price from the middleman to the purchaser, is used as the basis for determining transaction value.")

2. Customs' Directives

In Directive 3061071 (8 March 1993), Customs' Office of Trade Operations gave instructions to the field offices to assist import specialists in applying the principles of *Nissho Iwai*. Those instructions were:

i. Entered values based upon a sale from a manufacturer to a middleman may be liquidated once the importer has demonstrated to the satisfaction of the import specialist that the sale from the manufacturer to the middleman was a bona fide sale for export to the U.S. and was at arm's length. Import specialists are referred to Customs' notice on transfer pricing for guidance on what constitutes an arm's length transaction when parties to a sale are related (58 Fed. Reg. 5445 21 January 1993).
ii. Protests of entered values on liquidated entry summaries, based upon the decisions in *Nissho Iwai*, *Synergy*, Court No. 91-11-00836 (Ct. Int'l Trade 12 January 1993), *McAfee*, 6 Fed. Cir. (T) 92, 842 F.2d 314 (Fed. Cir. 1988), and related court cases, may be allowed once the importer establishes that the sale from the manufacturer to the middleman was a bona fide sale for export to the U.S., and was at arm's length, as indicated above.

Under this Directive, an importer need only show that the sale for export was a bona fide sale and was at arm's length.

In T.D. 96-87, 31 Cust. Bull. & Dec. 1 (1997), Customs Headquarters set forth the evidence necessary to complete a ruling request on the *Nissho Iwai* first sale valuation issue. Customs stated:

> [T]he requestor must describe in detail the roles of all the various parties and furnish relevant documents pertaining to each transaction that was involved in the exportation of the merchandise to the United States. If there is more than one possible sale for exportation, information and documentation about each of them should be provided. Relevant documents include, purchase orders, invoices, proof of payment, contracts and any additional documents (e.g. correspondence) which demonstrate how the parties dealt with one another and which support the claim that the merchandise was clearly destined to the United States. If any of these documents do not exist, or exist but are not available, the ruling request should so provide. What we are looking for is a complete paper trail of the imported merchandise showing the structure of the entire transaction. If the request covers many importations, it is acceptable to submit documents pertaining to some of the importations provided complete sets of documents are furnished, the underlying circumstances are the same, and the documents are representative of the documents used in all the transactions. Any differences should be explained.

T.D. 96-87 (footnotes omitted).

3. Customs Rulings

As indicated by the language of the valuation statute, and in accordance with the *Nissho Iwai* and *Synergy* decisions and Customs Service precedent, transaction value is usually based on the price paid by the importer. See HQ H017956 (23 February 2009). Where an importer requests appraisement based on the price paid by the middleman to the foreign manufacturer, and the importer is not the middleman, it is the importer's responsibility to show that such a price is acceptable under the standards set forth in *Nissho Iwai* and *Synergy*. The importer must present sufficient evidence that the alleged sale was a bona fide arm's length sale and that it involved goods clearly destined for the U.S.

For example, in HQ H017956 (23 February 2009), Customs examined the valuation of footwear imported from China and subject to multi-tiered transactions. The importer, the middleman, and the factories were all unrelated. The importer, Target Stores, was located in the U.S., while the middleman, Kenth Limited, was located in Hong Kong. Upon reviewing the transaction documents provided, Customs found that the documentation established that there was a sale of the merchandise between the middleman and the unrelated factories. Customs also found that the parties acted as buyer and seller, and acted at arm's length in the transaction. According to Customs, "[in] general, Customs will consider a sale between unrelated parties to have been conducted at 'arm's length.'" Id. citing T.D. 96-87.

Similarly, in HQ 546464 (3 April 1997), Customs found that there was a bona fide sale between the factory and the middleman (who was related to the importer) that could be used as the basis for transaction value, assuming that the importer in that case could provide the requisite transaction documents to Customs at the time of entry. HQ 546464 involved an importer, Fashion Resource, and its related middleman, TCL, located in Hong Kong.

Following the CAFC and CIT decisions, Customs has accepted the first sale price between the manufacturer and the middleman as the transaction value of imported merchandise when both the first sale price and the second sale price provide a statutorily viable basis for determining transaction value.

4. Evidence of Two Sales

To determine whether a sale has occurred between two parties, Customs evaluates the "overall view of the entire situation, with the result in each case governed by the facts and circumstances of the case itself". HQ 546998 (19 January 2000). "Sale" has been defined as a transfer of ownership in property from one party to another for consideration. *J.L. Wood v. U.S.*, 62 CCPA 25, 33, C.A.D. 1139, 505 F.2d 1400, 1406 (1974); *VWP of America, Inc., v. United States*, 175 F.3d 1327 (Fed. Cir. 1999). Though no one factor is dispositive, several factors may indicate whether a bona fide sale exists between a potential seller and buyer.

In determining whether property or ownership has been transferred, Customs considers whether the alleged buyer has assumed the risk of loss and acquired title to the imported merchandise. In addition, Customs may examine whether the alleged buyer paid for the goods, whether such payments are linked to specific importations of merchandise, and whether, in general, the roles of the parties and circumstances of the transaction indicate that the parties are functioning as buyer and seller. See *VWP of America*, 175 F.3d at 1339[53]; HQ 545705, dated 27 January 1995 (bona fide sale between importer and its corporate parent occurred where

[53] In *VWP of America, Inc*., the Court of Appeals for the Federal Circuit determined that a sale between the Canadian parent company and the U.S. subsidiary occurred: VWPC issued invoices to VWPA, and VWPA made payment to WVPC against those invoices. Moreover, the transactions were recorded in the books of the companies as sales. Under the terms of sale, VWPC transferred title to, and possession of, the fabrics to VWPA at the factory in St. Victor, Quebec. In consideration of the transfer of ownership, VWPA promised to pay the selling price. Every requirement for sale, as defined in *Woods*, was present in the transactions between VWPC and VWPA. Consequently, those transactions constituted sales for the purposes of 19 U.S.C. §1401a(b)(1). *VWP of America*, 175 F.3d at 1339.

importer had sole discretion in the selection and confirmation of its distributors and to negotiate prices, and conducted operations typical of a buying and selling business).

5. The Merchandise Is Clearly Destined for the U.S.

Customs gave examples of information necessary to prove that merchandise sold to a middleman was destined for export to the U.S. in HQ 545420 (31 May 1995). In that ruling, which involved garments purchased from factories in China through middlemen, Customs stated:

> [W]e note that the following information would support a finding that the requirement has been met: (1) The factory produces the garments to fulfill a pre-existing purchase order issued by the U.S. retailer; (2) the factory places labels in the garments which identify or represent the trademarks of U.S. retailers; (3) the factory packs the garments in shipping cartons which identify the U.S. retailer, by marks and numbers, as the ultimate destination; and (4) the export licenses controlling the volume of garments shipped to the U.S. cover specific garments.

In conclusion, the first sale strategy in the U.S. can serve two very beneficial purposes. First, where an importer purchases goods from a company that in turn is acquiring the goods from a factory, it may be that the dutiable value can be based upon the lower factory price (or an earlier price in a multi-tiered transaction). Second, where, as a result of tax planning strategies, a middleman is inserted into the supply chain in order to maximize tax savings, it may be possible to avoid the higher duty assessments that would otherwise result from the tax planning.

III. Classification

One of main components of compliance is that the importer has properly classified the merchandise so as to allow CBP to properly asses duty.

All products that are imported into the U.S. must be "entered" – declared to CBP – by the filing of documents that formally notify CBP that the goods have arrived or will be arriving shortly. These documents apprise CBP of the information that it needs to determine whether or not the product may enter the U.S., its appropriate value, and its proper classification, which determines the duty that is paid upon import.

The U.S. uses the Harmonized Tariff Schedules of the United States (HTSUS) as its product classification system for import duty purposes. The Harmonized Commodity Description and Coding System, (Harmonized System), is a multipurpose international product nomenclature developed by the World Customs Organization (WCO). The Harmonized System is used in about 170 countries around the world (covering about 98 percent of world trade) to collect import duties, trade statistics and internal taxes, to monitor controlled goods, and to determine eligibility for trade agreements (using "rules of origin"), among other uses. Its universality, therefore, has considerably streamlined global trade.

The Harmonized System consists of a series of six-digit codes, organized in a hierarchy of sections, chapters, headings and subheadings, that covers every product in the world. The six-digit level, however, is the starting point: each country is free to add digits that assist in providing a more specific description of a product. The hierarchical ordering of the Harmonized System means that an imported product must meet the terms of the superior breakout, such as a chapter and a heading, before it may be classified in one of the subheadings of any particular chapter.

In the U.S., a 10-digit classification is required for every imported product: the first six digits consist of the international Harmonized System basis, and the last four digits are a U.S.-specific breakdown of the more general classification. The HTSUS chapters proceed from unprocessed items, such as live animals in Chapter 1, to processed foodstuffs, chemicals, textiles and apparel, products of iron and steel, machinery and equipment, through high-technology semiconductors and other electronic equipment. Overarching direction for the classification of products that may sometimes fall, at first glance, in more than one classification is given by six General Rules of Interpretation for the international Harmonized System, and additional U.S. rules for many of the sections and chapters in the HTSUS. These rules lead to a single classification for every imported product.

The WCO reviews the Harmonized System every five years; the U.S. issues annual, or more frequent, updates to the HTSUS. The U.S. International Trade Commission administers the HTSUS and the current, and archived, versions of the HTSUS may be found at www.usitc.gov.

Of interest to luxury and fashion industry importers is the classification of textile, apparel, footwear and watch items. The HTSUS provides for the classification of textiles and textile articles in section XI, chapters 50-63, and for the classification of footwear in section XII, chapter 64. In particular, the section notes for section XI are very detailed and provide very specific directions as to the classification of textiles. As an example, one such detailed rule provides that:

> Goods classifiable in chapters 50 to 55 or in heading 5809 or 5902 and of a mixture of two or more textile materials are to be classified as if consisting wholly of that one textile material which predominates by weight over each other single textile material.

Chapters 50-55 cover silk, wool, cotton, man-made filaments, and man-made staple fibers; heading 5809 covers woven fabrics of metal thread and woven fabrics of metalized yarn, of a kind used in apparel, as furnishing fabrics, or for similar purposes, and heading 5902 covers tire cord fabric of high-tenacity yarn of nylon or other polyamides, polyesters, or viscose rayon.

Apparel items are also subject to similar detailed classification rules. For example, note 3 to chapter 61, which covers "Articles of Apparel and Clothing Accessories, Knitted or Crocheted", requires that a garment may not be classified as a "suit" unless it meets the following definition:

> The term "suit" means a set of garments composed of two or three pieces made up, in respect of their outer surface, in identical fabric and comprising:
>
> - one suit coat or jacket the outer shell of which, exclusive of sleeves, consists of four or more panels, designed to cover the upper part of the body, possibly with a tailored waistcoat in addition whose front is made from the same fabric as the outer surface of the other components of the set and whose back is made from the same fabric as the lining of the suit coat or jacket; and
> - one garment designed to cover the lower part of the body and consisting of trousers, breeches or shorts (other than swimwear), a skirt or a divided skirt, having neither braces nor bibs.
>
> All of the components of a "suit" must be of the same fabric construction, color and composition; they must also be of the same style and of corresponding or compatible

> size. However, these components may have piping (a strip of fabric sewn into the seam) in a different fabric.
>
> If several separate components to cover the lower part of the body are presented together (for example, two pairs of trousers or trousers and shorts, or a skirt or divided skirt and trousers), the constituent lower part shall be one pair of trousers or, in the case of women's or girls' suits, the skirt or divided skirt, the other garments being considered separately.

There are, also, as noted, specific chapter notes regarding the rules of classification that have been added by the U.S. to the HTSUS, which must be consulted in addition to the international section and chapter notes. For example, additional U.S. note 3 to chapter 61 provides that:

> For purposes of this chapter, statistical provisions for sweaters include garments, whether or not known as pullovers, vests or cardigans, the outer surfaces of which are constructed essentially with 9 or fewer stitches per 2 centimeters measured in the direction the stitches were formed, and garments, known as sweaters, where, due to their construction, the stitches on the outer surface cannot be counted in the direction the stitches were formed.

Additionally, the HTSUS classification for apparel items worn by men or boys sometimes differs from the classification of the same item worn by women or girls; the rate of duty applicable to each category may or may not differ also. For example, men's or boy's shirts, knitted or crocheted, of cotton, are classified in subheading 6105.10.0010 or .0030, respectively, each with a rate of duty of 19.7 percent. Women's or girls' blouses or shirts, knitted or crocheted, of cotton, are classified in subheading 6106.10.0010 and .0030, respectively; both also carry a duty rate of 19.7 percent. Men's and boy's swimwear, of synthetic fibers, are, however, classified in subheading 6112.31.00.0010 and .0020, respectively, with a duty rate of 25.9 percent, while women's and girls' swimwear, of synthetic fibers, are classified in different items in subheading 6112.41.00, with a duty rate of 24.9 percent.

A recent case illustrates the type of classification issues that arise. *Victoria's Secret Direct, LLC* v. *United States*, Nos. 2013-1468, -1469 (Fed. Cir. 16 October 2014) (VSD) was a classification case involving articles of apparel that are known in the trade as shelf bra camisoles. The importers, Victoria's Secret Direct (Victoria's Secret) and Lerner New York, Inc. (Lerner) alleged that their products were classifiable in Heading 6212, which covers "[b]rassieres, girdles, corsets, braces, suspenders, garters and similar articles and parts thereof". Specifically, the importers claimed the shelf bra camisoles were classifiable as "similar articles" to the exemplars specifically named in Heading 6212, under a theory of *ejusdem generis*. That is to say, because the shelf bra camisoles are characterized by providing support, they share the characteristic that unites the exemplars of Heading 6212, and are appropriately classified as "similar articles" within that provision.

CBP classified Victoria Secret's product, known as a "Shelf Bra" in "subheading 6109.10.00 of the HTSUS, which has a 16.5% duty rate and covers 'T-shirts, singlets, tank tops and similar garments, knitted or crocheted: Of cotton.'" CBP classified Lerner's product, known as a "Bodyshaper" under subheading 6114.30.10, which covers "[o]ther garments, knitted or crocheted" and has a 10.8 percent duty rate. The CIT tried both cases together, and concluded that both products were classifiable as "other garments" in Heading 6114.30.10.

In a 2-1 decision, the Court of Appeals for the Federal Circuit held that the imported garments were not classifiable in Heading 6212 pursuant to *ejusdem generis*, because, while the garments listed are united by the feature of providing support, they are also united by a “limitation inherent in the heading 6212 list”. The nature of the limitation is such that certain other articles of apparel, such as an evening gown or a pair of jeans, are not classifiable as “similar articles” in Heading 6212, even if those articles incorporate an element of support. The Court of Appeals relied on the CIT’s factual finding that “it would be inconsistent with facts the court found in this case to conclude that body support is the essential characteristic or purpose’ of either garment.” The Court of Appeals cited *Avenues in Leather, Inc.* v. *United States*, 178 F.3d 1241 (Fed. Cir. 1999), *Totes, Inc*. v. *United States*, 69 F.3d 495 (Fed. Cir. 1995), *Sports Graphics, Inc*. v. *United States*, 24 F.3d 1390 (Fed. Cir. 1994), and *SGI, Inc.* v. *United States*, 122 F.3d 1468 (Fed. Cir. 1997) to support its conclusion that classification “requires an analysis of particular headings and particular merchandise”.

The dissenting opinion criticized the majority for “rewriting the fundamental principles of a long established doctrine of statutory construction and by invoking an approach for classification of articles that [the Court of Appeals had previously] soundly overruled.” Specifically, the dissent believed that the majority misapplied the doctrine of *ejusdem generis*, as previously enunciated by that court. The dissent relied on *Avenues in Leather, Inc*. v. *United States*, 178 F.3d 1241 (Fed. Cir. 1999), in which the Court of Appeals had explicitly ruled that an item may have additional characteristics beyond the characteristic that unites a list of exemplars and nevertheless be classified as *ejusdem generis* with such exemplars.

To avoid such litigation, and obtain greater clarity, it is possible, and usually advisable, to request classification advice in the form of a ruling from CBP prior to importation; the ruling is binding on both the importer and CBP. CBP’s National Commodity Specialist Division in New York issues rulings on prospective import transactions, generally within 30 days of receiving the request. The following are examples of apparel-related ruling requests that apply the Harmonized Tariff System General Rules of Interpretation and specific U.S. rules:

- N210400 (5 April 2012): importer requested a classification ruling for a women’s cardigan, composed of 100 percent cashmere 1x1 ribbed knit fabric; the fabric measured more than nine stitches per two centimeters counted in the horizontal direction. This garment exceeded the sweater stitch count requirement of U.S. Statistical Note 3 to Chapter 61; accordingly, it was classified as an “other” cardigan, of cashmere, in subheading 6110.12.1060, with a duty rate of 4 percent ad valorem. The importer also requested a classification decision on a women’s long-sleeve shrug, constructed of 100 percent cashmere knit fabric. CBP determined that the shrug could not be classified in heading 6110 as a sweater, pullover, sweatshirt, or similar article because it did not sufficiently cover the upper body; instead, CBP classified it in subheading 6114.90.0570, which covers “other garments, knitted or crocheted”, of wool or fine animal hair, of cashmere, other: women’s or girls, with a duty rate of 12 percent ad valorem.
- N156817 (April 26, 2011): CBP classified a women’s belted, long-sleeve cardigan sweater, which extended to the knee, as a composite good classified as a unit under one tariff number. The sweater was constructed from 70 percent wool, 30 percent cashmere jersey fabric, the outer surface of which measured nine or fewer stitches per two

centimeters in the direction the stitches were formed. The composite good is classified according to the article that gives the good its "essential character", which, in this case was the sweater. Therefore, the sweater was properly classified in subheading 6110.11.0030, which covers sweaters, pullovers, sweatshirts, and similar articles, knotted or crocheted, of wool or fine animal hair, of wool: sweaters, women's, with a duty rate of 16 percent ad valorem.

Footwear, generally classified in chapter 64, has its own rules and notes. For example, subheading note 1 to chapter 64 provides that, for purposes of certain provisions in chapter 64, "the expression 'sports footwear' applies only to: (a) Footwear which is designed for a sporting activity and has, or has provision for the attachment of spikes, sprigs, cleats, stops, clips, bars or the like; (b) Skating boots, ski-boots and cross-country ski footwear, snowboard boots, wrestling boots, boxing boots and cycling shoes."

As noted, an importer may challenge a classification decision by CBP in the CIT. In 2008, the CIT reviewed a challenge to the classification of the UGG Classic Crochet model boot, which consisted of a knit upper that had no laces, buckles, or other fasteners, and a rubber sole. The importer argued that the boot was properly classified in subheading 6404.19.35, which covered "footwear of the slip-on type, that is held to the foot without the use of laces or buckles or other fasteners", among other items. The applicable duty rate was 37.5 percent. The importer argued that "footwear of the slip-on type" may only cover footwear that does not extend above the ankle – that is, shoes, and not boots – and, therefore, the boot in question was properly classified in subheading 6404.19.90, which covers "other" footwear with outer soles of rubber, plastics, leather, or composition leather, and where the applicable duty rate was 9 percent. The CIT determined that the boot was properly classified by CBP in 6404.19.35, as it was footwear of the slip-on type because it did not have fasteners and it could easily be put on or taken off. The Court of Appeals for the Federal Circuit agreed, noting that boots that are pulled on with the hands, without fasteners, are described by the term "slip-on".

The above examples describe just a few of the fact-specific and detailed arguments that are the basis for tariff classification decisions. In particular, this detailed examination is critical for the classification of certain luxury items such as wearing apparel and footwear. All importers, therefore, must be armed with specific knowledge of the products that they import, even if they were not the product's manufacturer.

IV. Country-of-origin Marking

Unless subject to very limited exclusions, every article of foreign origin (or its container) imported into the U.S. must be marked in a conspicuous place with its country of origin. This marking must be as legible, indelible and permanent as the nature of the article permits: it must indicate to the ultimate purchaser in the U.S. the origin of the product. Any imported article not properly marked is subject to marking duties equal to 10 percent of the value of the merchandise, plus possible liquidated damages and even penalties.

CBP has jurisdiction over the question of the country of origin of imported products. All goods imported into the U.S. or, in some circumstances, their containers, are required to be marked with their country of origin. The Federal Trade Commission (FTC) has jurisdiction over the use of the much more restrictive "Made in the USA" origin designation (and note the California Proposition 65 case mentioned at the outset).

"Rules of origin" determine the country of origin of a product. There are two basic categories of rules of origin: non-preferential and preferential:

- Non-preferential rules of origin are applicable when the transaction is not covered by a free trade agreement (FTA) or other special program.
  - Non-preferential rules can be subjective and may lead to a less-than-definitive answer.
  - Non-preferential rules of origin have long been used in international trade transactions; they were the norm before the proliferation of FTAs. These rules are generally based on the concept of "substantial transformation": were the components substantially transformed into a product with a new name, character or use? The rules were developed when products were generally entirely manufactured in one country (using inputs from that country). The export was generally the finished product and the country of origin was often simple to determine.
- Preferential rules of origin apply when an FTA or a special program applies to the transaction – and each FTA has its own rules, which differ among agreements. Therefore, a product that may qualify for the duty-free benefits of one FTA may not qualify for the duty-free benefits of another FTA.
  - Preferential rules of origin are more objective than non-preferential rules; they generally lead to a clear decision.
  - Each product within a preferential rule of origin scheme has its own rule of origin. Therefore, a rule of origin must be examined by FTA and by product.
  - In general, preferential rules of origin are based on two basic concepts:
    i. Local content requirement: was a certain percentage of value added in one (or more) of the countries that is a party to an FTA?
    ii. "Tariff shift": is the finished good classified in a different provision of the tariff schedule than the imported component(s)?
  - Preferential rules of origin may use one, or the other, or both, of these concepts within the rule for a particular product.
- Textile and apparel products have a specific set of non-preferential rules of origin that are less subjective and based on a set of objective rules.

Finally, there are a few other complications related to the issue of "country of origin":

- There is a different rule of origin scheme for sales to the U.S. government.
- There are different origin schemes for imported products and for products that are manufactured in the U.S.; the origin determination is governed by CBP for imported goods and by the FTC for goods that are made in the U.S. There are also different country-of-origin marking standards for these agencies.
- CBP determines country of origin for its purposes differently than the Department of Commerce does for antidumping purposes.

There is, therefore, no simple or single answer to the question of a product's country of origin. A company may have to record more than one country of origin for a single product because the question of origin is coupled with the question of “for what purpose?”. The rules are often complex and overlapping but, unfortunately, there is no simplification in sight.

V. Preferential Rules of Origin

These rules are specific to a product and an FTA or other special program. As an example, the rule of origin for gold necklace (classified in Harmonized Tariff Schedule subheading 7113.19.2180, under the U.S.-Korea Free Trade Agreement) is:

A change to heading 7113 from any other heading, except from heading 7116.

This is an example of a tariff-shift rule and it means that each of the non-originating materials contained in the necklace must be classified in a heading other than headings 7113 and 7116, which covers articles of natural or cultured pearls, precious or semiprecious stones (natural, synthetic or reconstructed).

The country-of-origin marking for goods from a North American Free Trade Agreement (NAFTA) country is determined by the NAFTA marking rules, a set of objective rules similar to the tariff-shift rules described above. The country-of-origin marking for goods from other countries is determined by applying the non-preferential rules of origin.

Textile and apparel products have a specific set of non-preferential rules of origin that are less subjective and based on a set of objective rules. In general, these rules provide for four general methods of determining origin, as follows:

a. Wholly obtained or produced: if a textile or apparel product is completely produced or manufactured in one country (with the exception of de minimis materials), the country of origin is the country in which the production occurs.
b. Yarn, including single and multiple yarns: The country of origin of yarn, thread, cordage, rope, cable or braiding is:
    i. Staple yarn: the county in which the staple fibers are spun into yarn;
    ii. Filament yearn: the country in which the filament is extruded;
    iii. Plied, gimped and cabled yarns: the country in which the fibers or filaments used in the yarn are spun or extruded.
c. Fabric: a fabric’s country of origin is the country in which the fabric is woven, knitted, needled, tufted, felted, entangled, or created by any other fabric-making process.
d. All other textile products: the country of all other textile products is the country in which the components are wholly assembled, except for minor attachments such as buttons, and beads, or minor subassemblies such as collars, cuffs and pockets.
e. Certain textile and apparel articles have special rules of origin: e.g., the country of origin of articles classified in certain HTS headings is the country in which the fabric is produced. For example, the country of origin of shawls, scarves, mufflers and the like of HTSUS heading 6214 is the country in which the fabric was produced. Additionally, the country of origin of knit-to-shape products is the country in which major parts are knitted or crocheted directly to the shape used in the finished product.
f. Additionally, however, each FTA to which the U.S. is a party has its own rule of origin related to textile and apparel items. Each FTA must be consulted separately.

VI. Country of Origin of Products Made in the U.S.

The FTC has jurisdiction over the country-of-origin determination of goods that are manufactured in the U.S. Generally, goods manufactured in the U.S. are not required to be marked with their country of origin.

If a product is labeled to show its U.S. content, it must comply with the FTC standards. To label a product “Made in the USA”, the product must be “all or virtually all” made in the U.S. “All or virtually all” means that all significant parts and processing that go into the product must be of U.S. origin. Therefore, the product should contain no, or negligible, foreign content. Also, to make this claim, the product’s final assembly or processing must take place in the U.S.

If an unqualified “Made in the USA” claim is not applicable to the product, an qualified claim may be appropriate. A qualified claim describes the extent, amount, or type of domestic content or processing (e.g., “60% US content’; “Made in USA of US and imported parts’; or “Couch assembled in USA from Italian leather and Mexican frame”). For this claim to be appropriate, the product’s last “substantial transformation” also should have occurred in the U.S.

An “Assembled in USA” claim is appropriate when the principal assembly takes place in the U.S. and the assembly is substantial. For this claim to be appropriate, the product’s last “substantial transformation” also should have occurred in the U.S.

Also, the Textile Fiber Products Identification Act and Wool Products Labeling Act generally require a “Made in USA” label on clothing if the final product is manufactured in the U.S. of fabric that is manufactured in the U.S., regardless of where materials earlier in the manufacturing process originated.

On a garment with a neck, the country-of-origin label must be positioned on the inside center of the neck, either midway between the shoulder seams or very near another label that is on the inside center of the neck. On other garments, the country of origin must appear on a conspicuous and readily accessible label.

In addition to country-of-origin monitoring, textile and most luxury and fashion goods must be labeled with the proper fiber content and care instructions. The rules governing those labels are different than most other countries’ and a prudent importer must be familiar with the U.S. rules, to avoid detention of goods, making duties, liquidated damages, and even penalties.

VII. Conclusion

Taken together, these issues can be daunting to an importer of luxury and fashion goods. Some suggested best practices are:

1. Having personnel well trained in the customs area and who can access information from other groups within the company, especially finance, tax (if sourcing from related parties), sourcing, design, etc. These departments should train and coordinate as often as possible.
2. Remember that the importer of record is always responsible for its customs declarations (including the individuals who own or manage the company). Do not over-rely on your customs house broker – these issues are too complex!

3. For related party transactions, perform a customs pricing study (appropriate to the size of and resources of the company) to justify the use of transactions value and establish procedures to deal with transfer price and other price adjustments.
4. Make certain to analyze and account for any assists, price adjustments, royalties and other indirect payments.
5. Confirm that the goods are properly classified and labeled.
6. If FTAs are used to reduce duty liability, ensure that the complex origin rules are followed and that all relevant data is up to date. These goods should be considered “conditionally duty-free’ until you are certain that you are in compliance.
7. Review whether you might benefit from the use of the first sale strategy. If you are using it, conduct periodic audits to make sure that the data is correct and current.
8. It applicable, remain knowledgeable about fish and wildlife restrictions and California Proposition 65.
9. Use CBP as an ally to protect your brands against counterfeit and gray market goods.
10. Be extremely careful when using TIBs and carnets.

VIII. International/Regional Concerns

A. European Region

Russia

In the Russian Federation, the import and export of luxury and fashion goods are governed by the same regulatory standards as the import and export of ordinary goods. Since luxury and fashion products generally include various types of goods, including apparel, accessories, watches, jewelry and electronic devices (the products), and since the products may include certain specific items, such as fur or skins of rare animals, precious stones and metals, or even encryption-based items (i.e., being part of various electronic devices), their importation and distribution in Russia may be subject to special statutory requirements.

1. General Scope of Russian Legislation on Imports and Exports

Russia is a member of the WTO and WCO, and its legislation on foreign trade and customs has been declared to be in compliance with the WTO and WCO Agreements. In addition to this, Russia is a party to the Commonwealth of Independent States (CIS) FTA and a member of the Customs Union (together with Belarus and Kazakhstan, the CU). Thus, Russian customs regulations are based on the supranational legislation of the CU, and for goods originating in the CIS, the CIS tariff regulations and rules of origin apply when imported into Russia.

The primary legislative Acts governing the import and export of goods, works and services in the Russian Federation are:

i. the Customs Code of the CU that came into force on 6 July 2010;
ii. the Federal Law on Customs Regulations No. 311, dated 27 November 2010, that came into force on 29 December 2010;

iii. a number of intergovernmental agreements executed by the member states of the CU establishing the CU and its main mechanisms and institutions, and regulating determination of the country of origin, payment of customs duties and value added tax (VAT), non-tariff restrictions, determination of the customs value of imported goods, liability of declarants (importers of record), mutual recognition of product certification, special measures of protection and other essential elements;
iv. decrees of the CU Commission, the community's regulatory body, that should primarily maintain common registers of customs brokers (agents), operators of bonded warehouses, preliminary classification decisions, etc. The CU Commission is also responsible for the approval of various implementing documents;
v. the Unified Customs Tariff of the CU that came into operation on 1 January 2010;
vi. Chapters 19 and 21 of the Russian Tax Code regulating the application of VAT (including import VAT and export VAT refunds) and excise taxes; and
vii. the Russian Code on Administrative Offences and the Russian Criminal Code establishing penalties for violation of customs regulations.

2. Customs Clearance and Types of Importation

The products may be imported into Russia by Russian importers of record (IORs) that could be either Russian legal entities, locally established branches of representative offices of foreign companies, or individuals. Foreign legal entities that do not have a legal presence in Russia cannot act as the IORs. Customs clearance formalities may be performed by customs brokers (representatives).

Imported goods may not be legally released for free circulation until customs authorizes the delivery (entry) of the goods into mainland Russian territory, confirmed by a special ("release granted") stamp of the customs authorities placed on the customs declaration. Imported goods are normally cleared at customs either before their shipment to the Russian customs territory or at the time the goods reach the designated customs house/post (and are placed in a special temporary customs warehouse, if needed). Depending on the type of product, its characteristics, and terms of delivery, certain specific issues may arise regarding part of their customs clearance. For example, products containing precious stones and metals should be cleared at specialized customs houses. Declaration of the products to customs must be performed on an accurate and precise basis in terms of determination and declaration of customs value, correct customs classification (HS) code and calculation of import customs duties and taxes due, as well as provision of all permission documents required per se. Any mistake made in a customs declaration, a failure to correctly calculate customs payables or to obtain the required permission documents in a timely manner may result in administrative or even criminal penalties for the IOR.

Customs clearance is normally completed by the IOR (or a customs agent acting on its behalf) filing the customs declaration (the main document) and the required set of documents. The list of documents required for customs clearance in each particular case depends on the type and characteristics of the goods and terms of their importation.

The timing for the customs clearance procedure is one business day after the date when a customs declaration was registered by the Russian customs authorities, provided that all the required documentation was submitted. However, in practice, the customs clearance process may take longer than the statutory term.

The legislation gives a customs inspector the right to extend that term by up to 10 business days, at the discretion of the chief of a customs terminal.

Based on the above, prior to beginning shipping products to Russia it is important to establish exactly all the statutory requirements and peculiarities that may be faced by the IOR, as well as to find an eligible customs broker who has considerable experience with customs clearance of a particular type of product.

Currently, all IORs in Russia are expressly required to undergo a preliminary registration with the Russian customs authorities for customs clearance purposes. Since 2004, Russian customs regulations have not contained such a requirement. However, in practice, the Russian customs authorities still open files on all IORs prior to the beginning of shipment operations and performance of customs clearance formalities. Without this, it is impossible to perform customs clearance formalities in Russia. At the majority of customs posts, the registration of the IOR usually coincides with the filing of the first customs declaration.

3. Tariff Regulations (Import Customs Duties)

The classification of goods for customs purposes in Russia is carried out in accordance with the Unified Customs Tariff of the CU, which is based on the Harmonized System, providing that all the goods crossing the customs territory of the CU are assigned customs Harmonized System codes determined in accordance with the general rules of interpretation of the Harmonized System. Customs authorities control the correctness of the classification of goods.

The latest version of the Unified Customs Tariff of the CU came into force on 23 August 2012 (as amended on 1 November 2014) with the rates of import customs duties set in accordance with Russia's obligations within the WTO, which were outlined in the Protocol of Russia's Accession to the WTO.

Import customs duties are calculated and imposed on the basis of the declared customs value confirmed and accepted by the Russian customs authorities. The rates of import customs duties in Russia normally range from 0 to 25 percent, based on the Unified Customs Tariff of the CU. For example, the rates of import customs duty for wrist watches vary from 10 to 14.7 percent; for all types of shoes with uppers of natural leather and resin/plastic/leather, the rate is set at €1.75 per pair; the rates for clothes and accessories of natural fur (hair, foxes, mink and nutria) vary from 10 to 20 percent; the rates for jewelry products vary from 10 to 18 percent.

The nominal rates of the Unified Customs Tariff of the CU apply to goods originating from approximately 130 countries with which Russia has established a "most-favoured nation" (MFN) regime. Normal rates of import customs duties apply to goods produced in MFN states. Lower rates (0.75 percent of the nominal value indicated in the customs tariff) apply to certain categories of goods originating in some developing countries, while no duties apply to products imported from the 48 least developed countries. Import customs duties may be deducted for corporate profits tax purposes.

In accordance with the Customs Code of the CU, at the request of the IOR, customs makes preliminary decisions on classification of goods (preliminary classification decision). Federal Customs Service of Russia issues preliminary classification decisions of the unified form established by the CU. This service is provided on a free-of-charge basis, and the statutory term is 90 calendar days. This document may be important in cases when products could be incorrectly classified by customs, with the application of higher rates of import customs duties. However, please note that in disputable cases, even a preliminary classification decision could state an incorrect Harmonized System code; thus, the IOR may have to confirm the correct Harmonized System code in court.

4. Country of Origin

The products' country of origin can be confirmed by a certificate of origin issued by competent bodies of a country where such products are originating, or by declaration of the country of origin, or by other commercial and shipping documents of the IOR.

Country of origin is important for the purposes of application of tariff preferences with respect to certain specifically listed products originating in developed/least developed countries, or originating in the CIS region. Country of origin is also important for the application of Russia's limitations imposed on certain specifically listed industrial and light industry products in the sphere of public procurement, or the application of Russia's sanctions imposing a ban on the importation of certain specifically listed food products. In all other cases, the country of origin of goods is not important for customs purposes.

However, the country of origin is important for local distribution of products: i.e., according to the laws on protection of consumers' rights, the goods' marking/labeling must normally indicate the name and address of the manufacturer and the IOR, as well as the company authorized to gather complaints from customers.

At the request of the IOR, the Federal Customs Service makes preliminary decisions on the country of origin. This service is provided on a free-of-charge basis, and the statutory term is 90 calendar days.

5. Customs Value

The customs value of goods imported into the CU is determined in accordance with the six methods of customs value determination established by the agreement of the CU "On Determination of Customs Value of Goods", dated 25 January 2008, and chapter 8 of the Customs Code of the CU. The above agreement directly refers to article VII of the WTO Customs Valuation Agreement.

The customs value of goods imported into the CU, which is used as a basis for calculation of import customs duties and taxes, includes the cost of goods, insurance costs and costs on transportation of the goods to the CU customs border. Depending on the actual circumstances, including contractual arrangements, an IOR may in addition have to include royalties (payable for the right to use trademarks and other IP rights in order to resell the goods) or other surcharges (e.g., freight charges, insurance costs) in the customs value of those goods, provided that the importer must directly or indirectly (e.g., via third parties) pay those royalties, other license fees and/or other income as a direct consequence of importation of the goods being valued at customs.

Legally, a Russian IOR may apply only the six above-mentioned methods for the determination of customs value, which must be confirmed by a certain set of documents that should be determined on a case-by-case basis. Any other rules, such as “first sale”, or transfer pricing rules, cannot be applied. Please note that during the review of declared customs value, customs may request the IOR to provide certain additional specifically listed documents confirming the customs value. In response, the IOR must provide either the requested documents or a written explanation of why all or some of the documents cannot be provided.

The right to control and confirm the correctness of the customs value is exclusively the competence of the Russian customs authorities’. The Russian tax authorities are not authorized to control the customs value of goods. The Russian customs authorities are always aiming at increasing the customs value of imported goods, in order to increase the amount of customs payments due.

The Russian customs authorities pay special attention to luxury products, since they are potentially expensive. For such goods, customs usually applies minimum rates of customs value determined on the basis of customs internal pricing databases. If the customs value of imported products is lower than the pricing information maintained by customs, the clearing customs post would likely attempt to adjust the customs value upward, which would probably lead to a number of practical complications for the IOR, including additional time and expenses required for customs clearance and customs value confirmation. Therefore, it is advisable to discuss the comparable prices with the IOR’s customs broker and negotiate the customs value with the clearing customs post, if required, well in advance. In the majority of cases, the courts have supported the importers of record, but, again, it takes a considerable amount of time to prove the correctness of declared customs value and for customs to return overpaid customs payables (i.e., a court case may last as long as three to six months).

Please note that the Russian transfer pricing (TP) rules that have applied from 1 January 2012 do not have any correlation with the customs valuation regulations; moreover, their principles are contradictory. Unlike customs, the Russian tax authorities would like to reduce goods’ prices, in order to maximize the taxable base. There are, so far, no real steps at a governmental level to unify these two sets of rules.

Thus, Russian tax and customs administrations are independent and their practical approaches to valuation of imported goods and interests are usually contradictory. This discrepancy might be challenging for Russian subsidiaries. Still, a careful strategy may help make use of TP rules for customs purposes.

6. Inclusion of Royalties in the Customs Value

Starting from 2010, the Russian customs authorities started scrutinizing almost all IORs in relation to the inclusion of royalties in goods’ customs value.

The regulations on inclusion of royalties into the customs value of imported goods are based on the WTO rules, but, practically, are interpreted more widely by Russian customs/courts: i.e., if there is evidence that the royalties refer directly/indirectly to the imported goods (e.g., calculated based on net sales of any goods in the region), they should, most likely, be included in the customs value.

It can be possible, however, to avoid the inclusion of royalties in the customs value. For example, there are legal grounds to claim that royalties should not be included in the customs value if the license agreement is structured in the following way:

i. Royalties do not directly/indirectly refer to the import contract (e.g., the royalties payable for know-how or application of the local marketing policy should not relate to the customs value);
ii. The formula for calculation of royalties is separated in any way from the imported goods (e.g., royalties can be paid for know-how, franchising, etc.); the amount of royalties should in no way depend on the imported goods and sales of imported goods (e.g., it could be a standard fixed sum).

Thus, the amount of royalties inclusive in the customs value can be minimized, provided that it is carefully structured.

Practically, the Russian distributors of branded products usually agree in advance with the trademark owners on the amount of royalties payable for the imported goods that need to be included in the products' customs value and other license payments (i.e., for the right to distribute, marketing/franchise fees, etc.) that do not relate to, and should not be included in, the goods' customs value. In order to avoid any additional questions from customs, the distributors should conclude several license agreements with the IP owners, one of which specifically covers royalties related to customs value (i.e., this agreement is provided to customs), and another that covers license payments that should not be included in the customs value (legally, the IOR does not have to provide such agreements to customs).

Please note that there are no regulations on the calculation royalties (i.e., it is a business issue). Therefore, the IOR should come up with a formula and customs should accept it. The formula should be structured in such a way as to avoid underpayment of import customs duties, since the IOR could face certain negative consequences otherwise.

7. Import VAT and Excise Taxes

Starting from 1 July 2010, payments of import VAT and distribution of the VAT between member states of the CU are based on a special agreement signed by the member states. The customs VAT applies to the sum total of the customs value and the customs duty. Import of goods is generally subject to Russian customs VAT levied at the same rate as Russian sales VAT (i.e., 18 percent). VAT is imposed on all goods imported into Russia, and also applies to the sale of goods, works and services in Russia. Import VAT may generally be offset against output VAT collected from local customers.

Certain specific types of goods are subject to a lower, i.e., 10 percent, rate of VAT (e.g., pharmaceuticals, children's products, some food products), while some other medical equipment and medical goods, art and cultural goods, etc., may be VAT exempt. However, this is unlikely to apply to the products.

Excise taxes apply to Russian imports of limited categories of products, like tobacco products, spirits, beer and other alcohol, and vehicles (as well as petroleum products, diesel and motor oil).

8. Non-tariff Regulations

Decision of the Commission of the Custom Union No. 134 “On Normative Legal Acts in the Sphere of Non-Tariff Regulations” establishes prohibitions and restrictions on certain types of goods and their components. For example, jewelry products may require special import formalities and assay supervision and marking. Skins and parts of rare animals may require a Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) certificate. Some electronic products containing encryption devices would require registration of a notification with the Russian Federal Security Service. The permission documents confirming that the products comply with applicable non-tariff regulations must be obtained well in advance of their importation into Russia.

Non-tariff measures can be applied on the basis of the products’ description and/or Harmonized System codes.

9. Technical Regulations and Sanitary Measures

In addition to the necessity to pay import customs duties and taxes, the goods may be subject to Russian sanitary (obligation to register with sanitary authorities certain types of products, primarily products for children) and quality certification requirements (receipt of a quality certificate of conformity, or declaration of conformity). The importer should provide to customs the document confirming compliance of the goods with sanitary requirements (i.e., state registration certificate) and quality requirements (i.e., declaration/certificate of conformity). There is no exemption from this rule.

State registration of products (if such products were not initially registered by manufacturers) is performed, in practice, within one to three months and requires performance of a number of tests that could delay the delivery of goods. Moreover, the fees for this service could amount to US$2,000-3,000 per product type.

Issuance of a declaration/certificate of conformity is not a lengthy procedure (it takes around one to two business days to get the relevant document from the certification laboratory); however, the service fees could amount to US$200 per document. Potentially, the Russian subsidiary could apply for a long-term declaration/certificate of conformity (i.e., for up to two to three years); the associated services fees in this case would be around US$2,000. The long-term declarations/certificates of conformity are issued only with respect to identical goods. Protection of IP Rights

The Russian customs authorities actively participate in the protection of IP rights. Trademark and copyright owners are entitled to register their IP objects with the customs IP Register, provided that the IP objects are protected under Russian laws. In every case of importing into Russia products bearing trademarks registered with the customs IP Register, the Russian customs authorities would check whether the goods are likely to be counterfeit and whether the IOR is authorized by the IP owner to import the products. Thus, the IP owner would be informed and would be able to take subsequent legal action against any unauthorized importation into Russia of products bearing its trademarks. Additionally, the Russian customs authorities would prevent importation of any counterfeit goods bearing the trademarks of luxury goods. The customs IP protection mechanism should soon be extended to the level of the CU, as the relevant basic regulations of the CU have already been adopted.

10. Importation of the Products by Individuals

Under the present rules, if effective, the products imported into Russia by individuals for personal use are completely exempt from the import customs payments if the customs value of the imported goods does not exceed €1,000 per month and the weight is less than 31 kilograms per month (this threshold is likely to be limited to €500 per shipment, starting in 2015). The products imported by or for individuals for personal use (in excess of these thresholds) are subject to an aggregate customs payment (i.e., there would be no separate import customs duty or import VAT). The standard rate of aggregate customs payment for the goods would be 30 percent of the goods' value, or €4 per 1 kilogram.

When clearing the goods imported by or for individuals, there are a number of practical problems that must be taken into account:

i. The customers as the importers of record are legally required to declare the products every time the products are imported into Russia, regardless of whether the above-mentioned exemption from import customs duties would apply.

ii. Declaration (customs clearance of goods) means physical submission to the Russian customs authorities of a completed customs declaration (completion of the customs declaration *per se* is a rather burdensome procedure). Moreover, the customer must, in person, visit the customs administration, which is usually located on the outskirts of cities or in airports, and spend at least several hours in a queue, as the customs inspectors are overloaded. These drawbacks could potentially be lessened if the goods were supplied by a regular post service; however, at the moment this is not a workable solution for on-line luxury goods stores, since the Russian post is known, unfortunately, for its significant delivery delays.

iii. The customer would need to prepare and provide to customs a number of additional documents: a scanned copy of the Russian internal passport, shipping documents (if any) sent by the shipper, product payment confirmation, etc.

This customs clearance procedure should be observed every time the customer imports something into Russia, regardless of whether the goods are delivered by regular post or by a freight forwarding company, such as DHL or UPS. The only exception is for the products delivered by regular international post, which are not subject to import customs payments (i.e., the products are normally declared by the Russian post).

11. Customs Inspections and Penalties for Customs Violations

a. Customs Inspections

Goods imported into Russia remain under post-clearance customs control for three years after the date of their release into free circulation. During this term, the Russian customs authorities may at any time audit the goods and review the legality of their importation into Russia. Russian customs authorities may arrange chamber or on-site customs audits (inspections) with respect to the IORs.

When the customs authorities reveal a customs legislation breach during a chamber (i.e., internal documentary) inspection performed internally at the customs house, based on the documents filed by the IOR at the time of customs clearance of goods, a targeted on-site inspection may be carried out. An on-site inspection should be performed within two weeks. However, in certain cases, it may be extended by one month. The customs authorities may use documents and information provided by Russian banks or tax inspection, as well as inventory and audit conclusions, and the conclusions of other state authorities.

On-site customs audits can be scheduled or non-scheduled. During such audits, customs may inspect premises where the imported goods are stored/placed, as well as all the internal commercial and accounting documentation. Please note that the customs authorities may check not only the declarant of the goods, the customs brokers, owners of temporary-storage and/or bonded warehouses and customs carriers, but also the legal entities authorized to dispose of the imported goods in the customs territory of Russia (e.g., the local downstream wholesalers and retailers of the imported goods).

b. Administrative Penalties

Based on the results of customs inspections, customs may hold the inspected company administratively liable for breach of the customs rules. Chapter 16 of the Russian Administrative Code (KoAP) provides for administrative fines and/or even confiscation of the imported goods. The most common customs violations include the following:

i. Article 16.2(1, 2) of the KoAP – non-payment/underpayment of import customs duties and taxes, due to non-declaration/inaccurate customs declaration (e.g., a failure to include royalties in the customs value of imported goods). The maximum administrative penalties for importers include a fine of up to 200 percent of the goods’ value, with or without confiscation of the goods.

ii. Article 16.2(3) and 16.3 of the KoAP – non-compliance with non-tariff regulations (e.g., import licensing), or other statutory limitations (e.g., mandatory certification of conformity). Maximum administrative penalties for importers include a fine of up to RUB300,000 (approximately US$7,500), with or without confiscation of goods.

Responsible managers of an IOR may also be subject to administrative penalties, in the form of a fine of up to RUB20,000 (approximately US$660). Individuals may also be subject to administrative penalties for the above types of customs violations.

The statute of limitations for all types of administrative violations in the sphere of customs regulations is two years, starting from the moment the goods have been released by customs. However, in the case of lasting/repeated violations, this two-year period runs from the date of discovery of the violation by the Russian customs authorities. Importantly, customs payments cannot be enforced after the expiration of the statute of limitations term established for post-clearance customs audits: i.e., more than three years after customs clearance of the respective goods.

Please note that confiscation of goods may be imposed only on the basis of a court decision; the customs authorities may temporarily arrest the imported goods, but may not confiscate them on an *ex officio* basis.

12. Criminal Sanctions

Russian law does not recognize the concept of corporate criminal liability. Only individuals (i.e., the managers of an IOR or a customs broker) responsible for a particular crime can face criminal penalties in Russia. Importantly, Russian law does not limit the application of criminal liability for corporate crimes to employees of the relevant corporate entity that committed the offense. Relevant crimes could include evasion of customs payments and smuggling in the sphere of export controls.

i. Article 194 of the Criminal Code establishes penalties for customs payment evasion. Depending on the gravity of the crime, the criminal penalties may include: a fine payable by individuals or legal entities from RUB100,000 (approximately US$2,500) up to RUB1 million (US$25,000), and/or mandatory works of up to 480 hours, or compulsory labor for up to five years with/without professional disqualification of up to three years, and/or imprisonment from two to five years.

Please note that a failure to pay customs duties may be qualified as a crime if:

a. the total amount of customs duties exceed RUB1 million (approximately US$25,000); and
b. there is proof of evidence of direct intent of a guilty person to evade.

Depending on the gravity of the crime, the statutory limitations period is from two to six years.

ii. Article 226.1 of the Criminal Code has penalties for smuggling in the sphere of export controls. The maximum penalties are up to 12 years of imprisonment, with a fine of up to RUB1 million (approximately US$25,000) and confiscation of the controlled items (the maximum limitation period is 15 years).

In practice, the Russian customs authorities are likely to automatically initiate a criminal investigation if the alleged amount of customs underpayments exceeds the above-mentioned threshold (i.e., RUB1 million).

13. Voluntary Disclosure of Customs Violations after Customs Clearance

Russian entities or individuals are not legally required to report any unveiled violation of Russian laws, so there are no penalties in Russian law for non-disclosure or failure to report.

Voluntary self-disclosure does not lead to exemption from liability and penalties, but self-disclosure could be viewed as an alleviating circumstance in an administrative case, and the Criminal Code provides for the possibility of exemption from criminal penalties if there is active repentance.

According to court practice in administrative cases, if an IOR immediately (i.e., within several days after the mistake is unveiled) corrects a mistake and reports it to customs, the IOR will have a chance to prove in court that it took all possible measures and acted in a bona fide fashion and, therefore, cannot be held administratively liable.

Therefore, voluntary self-disclosure could be viewed as a strong mitigation factor that can lessen penalties for administrative and criminal offenses. However, the self-disclosure option must be carefully considered on a case-by-case basis, and should take into account all the peculiarities of a situation.

Germany

1. Statute of Limitation

The statute of limitation for customs duties and import VAT is three years, beginning at the date of importation. Only in the case of fraudulent behavior can the statute of limitations be extended, up to 10 years.

2. Audit Mechanism

Depending on the statute of limitation, German Customs, in principle, audits importers every three years. However, as this would result in a heavy workload and practically is not feasible, German Customs has established an electronic risk assessment. Every person or company that clears goods with German Customs is entered into a centralized electronic database and tagged with a risk assessment number. The individual risk assessment number depends on numerous criteria (e.g., annual import volume, sensitivity of import goods, applicable duty rates, irregularities with respect to customs clearance in the past). The higher the risk assessment number is, the more often the particular importer of record will be subject to a customs audit.

3. Voluntary Self-disclosures

Voluntary self-disclosure is permitted in Germany (section 371 of the General Tax Act). The tax debtor is required to disclose to the full extent all relevant imports that led to underpayments of duties in the years not yet barred by statute. This should be done in writing.

In a voluntary self-disclosure, the taxpayer (here, the debtor of the customs duties) is required to pay the underpaid customs duties. If the underpaid customs duties exceed €50,000 per case, a surcharge of 5 percent is payable, in addition to the underpaid duty amount. However, no civil or criminal fines apply if the requirements of a voluntary disclosure are met.

Please note, however, that a voluntary disclosure is only possible if it is not already barred by certain circumstances. The most common reason why a voluntary disclosure is barred is the announcement of a customs audit. Once the tax debtor receives an audit announcement, a voluntary disclosure is not possible. If the requirements for a voluntary disclosure are not met (e.g., the possibility to disclose is already barred or not disclosed to the full extent), the disclosure can only be considered as a confession and, accordingly, the penalties can be lowered.

4. Potential Civil Penalties for Customs Violations

No late payment penalties apply if additional customs duties for customs violations are paid by the deadline set in the additional duty assessment note. Interest applies at the rate of 0.5 percent per month if the customs authorities classify the underpayment as intentional tax fraud (even if it is disclosed voluntarily).

5. Potential Criminal Penalties for Customs Violations

If potential customs violations are disclosed by German Customs and they believe that the underpayment is the result of gross negligent behavior, administrative penalties apply. The fine can be up to €50.000 per import.

If the customs authorities believe that the underpayment is the result of intentional behavior, criminal penalties apply, ranging from monetary penalties to imprisonment for up to 10 years.

Please note, however, that criminal penalties can only be imposed against individuals. Civil penalties can be imposed either on the company or on individuals. It is, however, more likely that customs will impose administrative fines on a company (e.g., forfeiture to the amount of the economic benefit) than on individuals.

6. Enforcement Climate

As electronic customs clearance has become mandatory, it is now easier for German Customs to disclose underpaid duties. The customs auditors use an electronic program to conduct audits. Therefore, they are able to find out about imports with potential misclassifications or about incorrect customs values quite easily.

In the case of these types of customs errors, the German Customs Administration is now more likely to open proceedings for administrative fines against the importing company.

Furthermore, the requirements for voluntary disclosure have been tightened as of January 2015. In particular, a surcharge will be due for underpaid duties in the amount of €25,000, on which interest will be due.

7. First Sale

“First sale” is currently available in Germany. However, it is under discussion that, in the upcoming European Union (“EU”) Customs Code, it will be abolished, and the latest draft does not contain it. The EU Customs Code will become effective as of 1 May 2016.

8. Transfer Prices vs. Customs Values

In our experience, German Customs does not communicate with the German tax authorities. However, customs auditors are understanding more and more the rationale of transfer price adjustments and their impact on the customs values of imported goods. Therefore, there is a tendency for customs auditors to ask for documentation on the transfer pricing policy of a company when they visit it for an audit. These documents, in particular, may serve to verify whether the relationship of the relevant companies negatively influenced the customs value of the imported goods.

If intercompany payments for transfer price adjustments were made, the transaction value method no longer applies. It is presumed by German Customs that the price paid was influenced.

Accordingly, one of the alternative valuation methods will apply to determine the customs value. However, German Customs believes that the determination of the customs value pursuant to the alternative methods must still follow the customs principles. Transfer pricing documentation serves solely as an additional indication of the amount paid.

In any event, retroactive transfer price adjustments that lead to underpaid customs duties must be communicated to German Customs. Usually, retroactive corrections have to be done per import declaration. However, as transfer price adjustments do not refer only to single imports but are deemed to cover a certain time period, multiple import declarations might be affected. Hence, it is nearly impossible to allocate an exact amount of the transfer price adjustments to each import. Therefore, it is common practice in Germany to approach the competent Main Customs Office and negotiate an appropriate method of calculating the additional customs duties payable as precisely as possible (e.g., based on an average duty rate) and to allocate the total amount to only one declaration.

If retroactive transfer price adjustment has led to overpaid customs duties, it is also possible to apply for a refund with the Main Customs Office. There is, however, no obligation to do so.

9. Dutiability of Royalties and License Fees

If royalties or license fees must be added to the customs value of a product, German Customs basically follows the same principles as the U.S.: i.e., the payment in question must be (1) related to the imported product; and (2) paid as a condition of the sale of the imported product.

The latter requirement is usually presumed if a purchase contract on the imported product is in place. However, whether the payment actually relates to the imported product is often difficult to answer. As a rule of thumb, if the costs are not already included in the purchase price upon importation (e.g., due to national tax regulations), the royalties or license fees for the use of, e.g., manufacturing know-how and trademarks are relevant to the customs value. In turn, payments for the use of, e.g., distribution know-how and application know-how are not relevant to the customs value, as these activities are carried out after importation of the product.

10. Trademarks Recording

Trademarks are to be registered with the German Patent and Trademark Office (*Deutsches Patent- und Markenamt* (DPMA)). It is a rather simple procedure: essentially, a special form must be filled out and submitted with the DPMA. The form can be downloaded at http://www.dpma.de/english/trade_marks/forms/index.html. With registration, the trademark is protected in Germany.

It is also possible to register a trademark with the Office for Harmonization in the Internal Market (https://oami.europa.eu/ohimportal/en/trade-marks-in-the-european-union). In this case, the trademark is automatically registered and protected in all European Union (EU) member states.

Once the trademark is registered, the trademark owner can apply for cross-border protection with the Central Office for Intellectual Property Rights in Munich. The Central Office for Intellectual Property Rights will inform all customs offices in Germany, in order to ensure the confiscation of goods if the customs officers entertain suspicion of infringements of property rights (e.g., falsification).

If a trademark is registered with the Office for Harmonization in the Internal Market, the application for cross-border protection will be forwarded to all EU member states. The trademark will therefore be protected throughout the EU.

11. Enforcement Climate for Counterfeits at the Border

If customs officers suspect infringements of property rights when they inspect goods, they suspend the release for free circulation for one day and notify the owner of the respective trademark. The owner of the trademark then has the chance to verify whether the trademark is actually infringed. If so, customs will take the necessary action, upon application of the trademark owner.

After application for cross-border protection, customs will automatically confiscate the goods under suspicion. The goods will be destroyed after 10 days, upon confirmation by the trademark owner. If, in turn, the customs declarant (i.e., the owner of the goods under suspicion) intervenes, the trademark owner must call on the Civil Court to clarify the potential infringement.

12. Country-of-origin Marking Requirements

There is a distinction in Germany between the preferential origin, the non-preferential origin and the "made in" origin.

a. Preferential origin

The preferential origin is relevant if the customs declarant (importer or exporter) would like to apply for preferential treatment for the goods to be imported or exported. As the rules for the preferential origin are laid down in the respective FTAs or other preferential programs (e.g., Generalized Scheme of Preferences), reference should be made to the explanations for the U.S.; the method of determining the preferential origin of the good in question is basically the same.

However, there is no obligation to mark the goods to be imported or exported. If preferential treatment should be applied, the origin must be indicated on the appropriate document (e.g., EUR.1, declaration of origin on the invoice).

b. Non-preferential origin

The non-preferential origin comes into play with respect to the question of whether or not import licenses/certificates are required or whether anti-dumping fees apply upon importation into the EU. The rules to determine the non-preferential origin are laid down in article 23 seqq. of the Community Customs Code.

In principle, goods have their non-preferential origin in the country where they were manufactured. If more than one country was involved in the manufacturing, the product shall be deemed to originate in the country where it underwent its last substantial and economically justified processing. However, any processing that justifies the presumption that its sole object was to circumvent the provisions applicable for a specific country (e.g., anti-dumping fees) shall not be deemed to confer origin of the country where it is carried out (e.g., repacking, cleaning). In other words, the processing in a country must lead to an advanced stage of processing of the product; the minimal treatment threshold must be exceeded.

Please note that with respect to the non-preferential origin, the EU is considered one territory.

In any event, there is no obligation to mark the goods if the non-preferential origin is relevant. The non-preferential origin must be proved by a certificate of origin that is issued by the local Chamber of Industry and Commerce.

c. "Made in" origin

The third type of origin available in Germany is the "made in" origin. There is no obligation in Germany to indicate the "made in" origin on goods to be imported into the EU. There is only the option to do so.

However, if an importer decides to mark the goods to be imported with the "made in" origin, the indicated origin must be correct. Otherwise, competitors can claim compensation for damages due to misleading declaration of origin.

In principle, the legal basis for the "made in" origin is the "Madrid Agreement and the related Protocol concerning the international registration of marks", as well as the German Fair Trade Practices Act. However, these regulations do not contain concrete rules on how to actually determine the "made in" origin of a certain product. Therefore, in numerous cases, the origin has had to be determined through a lawsuit. The respective rulings indicate that reference is to be made to the rules for the determination of the non-preferential origin.

B. America Region

Mexico

For many years, the footwear and apparel sectors have been considered sensitive sectors for the Mexican government and have been highly protected. After the accession of China to the WTO in 2001, Mexico had to eliminate anti-dumping duties imposed on footwear and apparel. However, it has been implementing several mechanisms to avoid unfair practices, especially undervaluation, being imposed on these sectors.

On 29 August 2014, the Ministry of Economy (SECON) published in the Federal Official Gazette (FOG) a Decree establishing measures for the productivity and competitiveness of, and to avoid undervaluation practices in, the footwear sector (the Decree).

The Decree establishes that SECON and the Ministry of Finance and Public Credit (SHCP) will implement (i) the necessary measures to increase the productivity and competitiveness of the Mexican footwear industry; and (ii) permanent actions to prevent and avoid undervaluation practices by specialized risk analysis methodologies, and establish non-tariff regulations and restrictions, including a requirement for registration with a specific sector for footwear under the Importers' Registry, and mechanisms to monitor the customs value of footwear, among other measures. These measures were implemented in separate publications by SECON and SHCP, and include the following:

i. The tariff phase-out on footwear products that was originally programmed for 2015 has been reprogrammed to become effective on 31 January 2019. Therefore, instead of continuing the phasing out of duties, whereby next year 14 tariff classifications applicable to footwear would be subject to 20 percent duty, they will remain subject to duties of 25 and 30 percent.

ii. Estimated prices imposed on goods of the footwear industry. Where a good is imported declaring a customs value lower than the estimated price, the importer must file, along with the import duty document (pedimento), a document demonstrating the payment of a deposit, or guarantee issued by a credit institution, of the difference between the duties and taxes paid based on the declared customs value and those that would have to be paid if the estimated value had been declared.

iii. Exclusive customs houses. As of 1 October 2014, imports of footwear may only take place through nine customs houses: namely, Lazaro Cardenas, Manzanillo, Mexico City, Guadalajara, Veracruz, Tijuana, Mexico City international airport, Ciudad Hidalgo and Nuevo Laredo.

iv. As of 1 October 2014, importers of footwear need to be registered in the Importers' Registry's Specific Sectors.

v. Prior Notices. The Mexican Customs Authorities will implement a system of prior notices, by means of which the importer will need to notify the customs authorities at least five days before an importation of footwear takes place. The importer will need to enclose with the prior notice a copy of the sales invoice and the documents related to the insurance and freight related to such goods.

vi. Reviews and audits to importers of footwear. At the time of importation, all imports will be reviewed and, based on the historic information related to undervaluation, the number of reviews may increase. Moreover, customs will increase the number of post-import audits and reviews, to review internal taxes paid by importers of footwear.

vii. Industry "observers". SHCP will invite the Chamber of the Footwear Industry to designate "observers" that will verify and observe import operations in the different customs houses, in order to ensure that the applicable legal provisions are duly met at the time of importation.

viii. Tariff classifications for footwear products will be modified and extended, so that, instead of having eight digits, they will have 10 digits.

ix. Omissions in compliance with the foregoing requirements will cause SHCP to suspend the company from the Importers' Registry.

1. Legal Framework

In addition to payment of duties and VAT, imports of footwear, apparel goods, leather items and other luxury goods are subject to compliance with several non-tariff regulations (such as import permits, import quotas, country-of-origin certifications, anti-dumping and countervailing duties) and Mexican Official Standards (NOMs). These requirements are established by the authority imposing the restriction, by means of an administrative resolution that must be published in the Federal Official Gazette and list the goods subject to the regulation or NOM, by tariff classification and tariff description.

Goods that are subject to NOM compliance upon importation into Mexico are specifically identified by tariff item in an administrative resolution published by SECON as part of its Foreign Trade General Rules (the NOM Accord). Where a good is not listed in the NOM Accord, the good will not be subject to NOM compliance upon importation. However, it may be subject to NOM compliance at the time of retail in Mexico.

There are two generic types of NOMs that may apply to a product:

- Technical NOMs. These set forth specific technical specifications that must be met by the product. If technical NOMs are applicable to the product, the importer must obtain NOM certification prior to importing the product into Mexico.
- Commercial information NOMs (labeling NOMs). These regulate the terminology, symbols, labeling or marking that must be displayed on products and, as applicable, their instruction manuals and warranty cards.

In Mexico, the labeling of both domestic and imported products is regulated by the Federal Law on Consumer Protection (FLCP) and, depending on the type of product, different labeling NOMs. The general labeling requirements are set forth both in the FLCP and in NOM-050-SCFI-2004[54] (NOM-050). Depending on their characteristics, goods may be subject to more specific labeling NOMs. However, where a good is not subject to a specific NOM, NOM-050 will apply.

2. Customs Law

In terms of the customs law, lack of compliance with applicable non-tariff regulations and NOMs is subject to the following penalties:

i. If the omission is discovered by the customs officials upon customs clearance, review of goods upon transportation or in an audit at the premises of the importer, an administrative procedure in customs matters (PAMA) will be initiated and the goods provisionally seized. The importer will have 10 days to demonstrate that it complied with the applicable non-tariff regulation or NOM. Regarding labeling NOMs, the importer will have 30 days to comply.
ii. Omission in compliance with non-tariff regulations and/or technical NOMs will lead to a fine of between 70 and 100 percent of the commercial value of the goods.
iii. If the applicable NOMs were labeling NOMs, the fine would be between 2 and 10 percent of the commercial value of the goods.
iv. FLCP

If the omission of NOM compliance is not discovered by the customs authorities but upon retail by the Federal Consumer Protection Agency (PROFECO), the sanctions are as follows:

- PROFECO may request the retailer to “remove the product from shelf” (immobilize it) until the product is reconditioned to meet the NOM requirements; and.
- monetary fines ranging between US$$47 and $185,750.

v. Federal Law on Metrology and Normalization

In addition to the fines set forth in the Federal Law on Consumer Protection, SECON, through PROFECO, may impose the following sanctions:

- fines ranging between US$$100 and $15,528;
- temporary or definitive closing of the business where the goods are retailed; and
- administrative detention.

[54] NOM-050-SCFI-2004 – Commercial Information – General Provisions for Products.

In terms of the Federal Tax Code, contraband is committed when introducing goods into the country or extracting goods:

i. without paying the applicable duties, taxes and/or countervailing duties;
ii. without permit from the competent authority, when applicable; and
iii. when their import or export is prohibited.

There are also several types of conduct that lead to presumption of contraband, such as:

i. When the authorities discover foreign goods without the customs documentation demonstrating that the goods were subject to the customs clearance procedure set forth in the Customs Law.
ii. Certain cases of undervaluation.
iii. Incorrectly declaring the description or tariff classification of goods when this causes omission in payment of duties and/or taxes, except when the customs broker can demonstrate that he or she strictly met all the obligations set forth in the customs and foreign trade provisions.
iv. Extracting from the customs house containers containing alcoholic beverages that have not been duly marked with the necessary tax precincts/labels.
v. Falsely certifying the origin of goods so that they are imported into a country with which Mexico has a FTA and claiming preferential duty treatment, so long as the FTA provides sanctions in this respect and there is reciprocity with the importing country. It will not be considered smuggling when the exporter informs the customs authority and those who received the certificate of origin that the certificate was false.
vi. Filing with the customs authorities false or altered documentation.

The penalties for smuggling range between three months and nine years of imprisonment, depending on the specific conduct.

With regards to administrative fines and penalties, in general terms, the statute of limitations is five years as of the date of importation/exportation.

Regarding criminal liability, SHCP is allowed to file a complaint (*querella*) and issue a damage statement to the Federal Treasury, during the five years following the date when the felony took place. However, the term for exercising criminal action is equal to half of the term of imprisonment set forth in the Federal Tax Code but, in any case, will be less than five years.

As mentioned earlier, the Mexican authorities have expressed considerable interest in the luxury and fashion industry, as indicated by all the recently adopted import regulations. As a result of the foregoing, SHCP and the General Customs Administration are closely monitoring compliance with all tariff and non-tariff regulations applicable to the industry. Because many new measures have been implemented recently, it is very likely that SHCP will increase the percentage of audits on importers of footwear and apparel, and also on goods subject to IP rights.

The Mexican government has not developed a clear voluntary disclosure mechanism. However, the Federal Tax Code contains a provision setting forth that no fines may be imposed when the omission is not discovered by the authorities. This provision is the basis for voluntary disclosures.

In principle, the way to pay omitted duties and taxes, or to correct errors declared in pedimentos, is to rectify each specific pedimento where the omission/error was made. However, it is also possible to approach SHCP to inform it that the company has determined it did not duly pay duties/taxes, or made errors in its import declarations, and request SHCP to issue an invitation letter. This document will invite the company to review its customs transactions and voluntarily pay any duties and taxes that the company determines it has omitted. The advantage of this procedure is that it reduces the risk of being audited while the company is in the process of determining the amount of the omissions.

The advantage of a self-disclosure is that, while the company will have to pay omitted duties and taxes, along with adjustments for inflation and late payment interest., no fines will have to be paid. Considering that the fines for omission in payment of duties range between 130 and 150 percent of the omitted duties, and the fines for omissions in VAT range between 50 and 70 percent of the omitted taxes, self-disclosure may mean considerable savings.

The tax authorities may carry out audits by means of visits to the domicile of the taxpayer (*visita domiciliaria*), where the auditors will review the relevant documents and information, or by means of an desk review (*revisión de gabinete),* whereby the taxpayer must deliver accounting records, and other documents and information, for review by the auditors at their office and then issue the corresponding resolution.

Before the initiation of an audit, the auditors must serve a notice informing their intention of carrying out a visit. This notice must be delivered to an individual with a power of attorney granted by the company to act for the company. If the attorney is not present, the auditors must leave a notice and come back the following day to serve the initiation of the audit. As a result of recent amendments to the provisions of the Federal Tax Code, all taxpayers have a digital tax mail (*buzón tributario*), which is an electronic communication system located at the website of the Tax Administration Service (SAT). As a result of this amendment, the tax authorities may serve official letters through the digital tax mail instead of personally visiting the premises of the taxpayer. To this end, taxpayers must appoint five individuals authorized to receive emails from the SAT. The addressees will receive an email instructing them to access the SAT internet portal in order to receive an official notice. The notice starting the audit must specify the documents and information that the taxpayer must supply and the term for supplying the requested information.

In general terms, the audit must be concluded within one year as of the date when the initiation of the audit was served. This term will be suspended in the event that the taxpayer challenges the acts or activities resulting from the exercise of auditing powers, starting the date that the appeal or other defense is filed and ending when a definitive resolution is issued.

3. Customs Valuation

In Mexico, the “first sale” rule has not been implemented. Thus, the transaction value is the price *paid or payable* in the sale where the goods are *sold for export* and *purchased by the importer*.

In some cases, the documentation provided for transfer prices purposes is sufficient to demonstrate that the transaction value method was correctly used and that the declared value is accurate.

In those cases in which such documentation is not sufficient to demonstrate that the transaction value is acceptable, some documents that may be used to demonstrate that, and also as evidence that the declared customs value is accurate, are as follows:

- letters of credit, negotiable instruments or transfers of money demonstrating the payment made by the importer to the supplier;
- a purchase and sale agreement between the importer and the foreign supplier, which refers to the terms of the negotiation;
- a bank account statement reflecting the payment made by the importer to the foreign supplier;
- if required, a certified (*apostilled*) commercial invoice; and
- documents evidencing transportation, insurance and related expenses, such as handling, loading and unloading.

Both customs and the tax authorities are part of SAT, and they are coordinated to review compliance with the applicable legal provisions for customs and tax purposes.

SAT has implemented a mechanism in the Foreign Trade General Rules that allows importers to rectify the customs value declared upon importation using a single declaration, instead of having the obligation to rectify each single import declaration, subject to certain requirements.

Royalties and license fees are dutiable when their payment is a condition of sale and such royalties and license fees are related to the goods the subject of valuation.

In this regard, if the royalties for the right to use a trademark are calculated on the amount of the imported product that is sold during a specific period of time, such royalties will be dutiable. On the other hand, if the marketing know-how around the trademark is considered an independent service, and is calculated on a different basis than the amount of product imported and/or sold, it may be considered non-dutiable.

4. IP Rights

There is a process for recording trademarks with customs, which came into force in early 2012, on a database operated by the customs authorities. While recordation on this database is not mandatory, it is highly recommended, as doing so facilitates enforcement actions at the border, allowing quicker preventive seizures either by the Federal District Attorney General Office or the Mexican Patent and Trademark Office, as the authorities will be working in coordination as soon as the trademark owner files either a criminal complaint or an administrative infringement action.

The registration process is simple, with the owner filing a brief that includes the following information:

i. trademark registration number, trademark and term of validity;
ii. general information about the trademark owner and legal representative in Mexico (name, address, telephone, email address);
iii. import/export tariff classification, and detailed description of the merchandise, including specifications, technical characteristics, and other necessary elements;
iv. name and federal taxpayer registration of the trademark importers, distributors or licensees;
v. port of entry and period when the legal merchandise normally enters the country; and
vi. photographs of the goods and, if applicable, of their packaging or packing material.

There is no government fee for recording trademarks with customs.

The Mexican Customs Office is very proactive in its anti-counterfeiting efforts. It works very closely with the trademark title holders and their representatives to keep them informed about importation of counterfeit goods, and is keen on facilitating quick seizures of counterfeit goods. Also, customs periodically organizes anti-counterfeiting training sessions with trademark title holders to inform them about counterfeiting trends and key issues to look for when reviewing alleged counterfeit goods. While the Customs Office lacks legal authority to seize the goods *ex officio*, it is always open to working with the trademark title holders to deter counterfeits.

5. Country-of-origin Marking

Both the FLCP and the applicable NOMs (including NOM-050, which covers goods that are not subject to a more specific NOM; NOM-004-SCFI-2006, which regulates the labeling of textile and apparel goods; and NOM-020-SCFI-1997, which regulates the labeling of footwear and other leather products) require that the country of origin is marked on the products' labels. The country of origin is normally defined as the place of manufacture, production or assembly of a product.

When a product is produced in a NAFTA territory, the rules to determine the country of origin for marking purposes are included in the administrative regulation, which sets forth the country-of-origin-marking rules to determine when an imported good can be considered a U.S. or Canadian good pursuant to NAFTA (the NAFTA Marking Rules).

On the other hand, when a product is produced in a country that isn't a NAFTA country, the country of origin for non-preferential purposes must be determined in terms of the provisions of the administrative regulation, which sets forth the rules for the determination of the country of origin of imported goods and the provisions for their certification, for non-preferential purposes.

It should be noted, however, that when a product is produced in a country with which Mexico has entered into an FTA (other than NAFTA), and the product qualifies as an *originating good* for the purposes of such an FTA, such a country must be declared the country of origin for marking purposes.

Brazil

1. Legal Regime

The tax system in Brazil is decentralized in three different levels (federal, state and municipal). The result is a complex set of rules and a potential increase in tax costs, which restrains the development of local industries, including the luxury and fashion sector.

Specifically regarding the luxury and fashion industry, it is important to note that certain Brazilian taxes follow the constitutional principle of selectivity (princípio da seletividade). This means that the rates of such taxes are inversely proportional to the essentiality of the product, so that luxury and fashion products have a higher tax burden when compared to goods from other industries, such as pharmaceutical products.

From a customs perspective, luxury and fashion goods are subject to the same rules and restrictions that are generally applicable to import transactions into Brazil. Following this rationale, imports into Brazil are subject to the control of Brazilian authorities through an electronic system called SISCOMEX, which involves a computer network shared by the Federal Revenue Department (RFB), the Foreign Trade Department (SECEX) and the Central Bank of Brazil. All import documents must be registered in SISCOMEX. In order to obtain access to

SISCOMEX, the Brazilian importer must request from the RFB authorization to operate in the system through a password.

The importer may be entitled to limited or unlimited RADAR[55] registration. Limited registration is a limitation on imports up to a value of US$150,000 within a six-month period. Unlimited registration has no restriction on the amount or frequency of imports. The granting of the RADAR licenses by RFB is discretionary, and involves consideration of the financial capacity of the company. The analysis of financial capacity by RFB is based on the amount of federal taxes collected by the applicant company.

Moreover, some goods may be subject to import licensing, i.e., an authorization from the Brazilian authorities. Thus, to confirm the licensing requirement applicable to a specific product, the Brazilian importer must consult SISCOMEX, which will notify it, based on the tariff classification of the product, whether or not its importation is subject to licensing.

Based on the Customs Regulations (Decree No. 6,759/09), the most important penalties applicable in the context of customs control are the following: (i) a fine corresponding to 1 percent of the customs value of the good in the case of incorrect information, including the product's tariff classification, provided in the import documents; (ii) a fine corresponding to 30 percent of the customs value of the goods in the case of importation without the applicable import license or if the goods are shipped before the issuance of the import license; (iii) a fine corresponding to 100 percent of the import duty value in the case of use of forged documents to obtain tax benefits and lack of presentation of goods, subject to the bonded warehouse customs special regime; and (iv) a 75 percent statutory penalty, plus interest, for lack of payment of taxes, which can be increased to 150 percent in the case of fraud.

Still on the topic of customs penalties, the seizure penalty is a severe penalty applicable to specific situations listed in article 689 of the Customs Regulations. The following kinds of conduct, among others, are subject to the seizure penalty: exposure for sale, deposit or commercial circulation in Brazil foreign goods without evidence of regular importation; importation of goods based on false documentation; falsification of foreign goods; omission of the actual importer, in the case of simulation or fraud; and importation of goods without the import license, when its issuance is suspended or prohibited.

From a criminal standpoint, the applicable penalty for smuggling or embezzlement is imprisonment for one to four years (article 334 of the Criminal Code – Decree Law No. 2,848/40).

The statute of limitation applicable to the taxes levied upon importation and customs-related infractions is five years, counted from the customs clearance (article 150 of the National Tax Code). During this period, the taxpayer shall keep the tax and import/export documents, which must be available to the authorities, if requested, in paper or electronic form, at the legal entity's premises.

In regard to the enforcement climate, we have seen in the last few years an inclination by the customs authorities to assess the importer in respect of the customs valuation, which usually happens not only during the customs clearance, but throughout the five years within the statute of limitation (i.e., the so-called customs review procedure). Another common issue is the tariff

[55] "RADAR" (Sistema de Rastreamento da Atuação dos Intervenientes Aduaneiros) is the name of the importers and exporters electronic registry managed by the RFB.

classification of imported products. Misclassification usually results in a difference in the applicable tax rates or the applicability of import licensing requirements.

Specifically, regarding the luxury and fashion sector, we refer to a joint operation performed by the Federal Police and the Brazilian Federal Revenue in 2009. This was against one of the most famous stores of imported luxury items in Brazil, and related to under-invoicing upon importation and, as a consequence, underpayment of taxes. The investigation resulted in the imprisonment of the company's shareholders, due to various crimes, including embezzlement. From this episode, we may infer that the scrutiny of customs authorities of imports of luxury and fashion goods into Brazil has increased in the last few years.

The voluntary disclosure of tax debts is regulated by article 138 of the National Tax Code. According to this article, taxpayers that voluntarily pay pending debts, before the beginning of any tax audit, are exempted from the payment of penalties. The wording of the rule is broad, and there are good grounds to argue that the exemption encompasses both late payment and statutory penalty.

However, the Brazilian tax authorities usually do not recognize the effects of voluntary disclosure upon the 20 percent late penalty and, for this reason, as a rule, the main advantage of the voluntary disclosure is the avoidance of the 75 percent statutory penalty for lack of payment of taxes. For the purposes of avoiding the collection of the 20 percent late penalty, the taxpayer is usually forced to file a judicial lawsuit to have its right acknowledged.

Once the payment, or the difference in taxes, is made, the importer is required to rectify the import declarations that are the object of the voluntary disclosure registered in the past five years.

The customs authorities are allowed to review the import transactions performed by the taxpayer within five years from the customs clearance aimed at detection of customs-related infractions and lack of payment of taxes. This procedure is the so-called "customs review".

During the course of the customs clearance procedure, the customs authorities also have the chance to verify the accuracy of the information provided by the importer and perform a physical inspection of the shipment. This verification occurs through the following inspection channels:

- green channel: automatic customs clearance (no examination or analysis);
- yellow channel: analysis of the import documents;
- red channel: analysis of the import documents and physical examination; and
- gray channel: analysis of the import documents, physical examination of the imported goods and adoption of special control procedures.

2. Customs Valuation

Brazil is a member of the WTO and has adopted the WTO's rules through Decree No 1,355 of 30 December 1994. In fact, Decree No. 1,355/94 reproduces article VII of the General Agreement on Tariffs and Trade (GATT 1994) and the Agreement on the Implementation of Article VII of GATT 1994 (WTO Customs Valuation Agreement).

In addition to that, Brazil has a few provisions regulating customs valuation, such as Normative Ruling No. 327/03. It is important to note, however, that Brazil does not accept the application of the "first sale" strategy for the purposes of determination of the customs value.

Although Brazil follows the WTO customs valuation rules, from a practical standpoint, the customs value control of products imported into Brazil occurs on a selective basis through SISCOMEX. The products are usually submitted to the customs valuation control procedure, based on SISCOMEX parameters. These parameters correspond to minimum and maximum ranges of prices acceptable for each tariff classification. It should be noted that these ranges are confidential.

If the price of importation of a specific product falls outside SISCOMEX parameters, the customs official may request the importer submit a declaration of customs value, and documents attesting the adequacy of the value declared by the Brazilian importer. The Brazilian importer may demonstrate differences in commercial levels, quantity levels, and other relevant elements and costs incurred by the exporter in sales to non-related parties.

Regarding transfer pricing, Brazil has very "peculiar" rules that do not follow the Organisation for Economic Co-operation and Development (OECD) guidelines, but, rather, are mainly based on statutory minimum/maximum profit margins.

In this sense, it is possible to say that customs and transfer pricing rules work in opposite directions in Brazil. That is because, while the customs valuation rules aim to ensure the minimum taxable basis with respect to the taxes levied upon import, transfer pricing rules were developed with the purpose of determining the maximum amount of deductible expenses for corporate tax purposes on transactions between related parties, including the importation of goods.

Therefore, from a practical standpoint, it is common to have a situation in which the price of the imported goods, although in accordance with the WTO customs valuation rules, is higher than the maximum deductible price for corporate income tax/transfer pricing purposes. In this case, the Brazilian taxpayer is required to adjust the value for corporate income tax purposes, although it is not required to adjust the customs value and seek reimbursement of the "excess" amount of taxes paid upon customs clearance, as the transfer pricing adjustment is for income tax purposes only.

With respect to the dutiability of royalties and license fees, Brazil follows the general rule in article 8, item I, "c" of the Customs Valuation Agreement: i.e.: "*1. In determining the customs value under the provisions of Article 1, it shall be added to the price actually paid or payable for the imported goods: (c) royalties and license fees related to the goods being valued that the buyer must pay, either directly or indirectly, as a sale condition of the goods being valued, to the extent that such royalties and fees are not included in the price actually paid or payable*".

With respect to case law, we refer to the Request for Ruling No. 483/09, which defines "sale condition" as one that is intrinsically and inseparably related to the feasibility of the goods' commercialization in Brazil. In other words, the commercialization of the goods in Brazil would not be allowed without the payment of the royalties.

Another interesting precedent on the inclusion of royalties in the customs value is Decision No. 3402-002.444/14 of the Administrative Court of Appeals (CARF), in which it was decided that the royalties and licensing fees shall be included in the customs value when the following requirements are cumulatively attended: (i) direct relation with the goods that are the object of the valuation; (ii) characterization of a "sale condition" imposed by the seller–exporter who shall be the holder of the royalties and licensing rights; and (iii) the fees shall be due directly or indirectly by the purchaser–importer to the seller–exporter, even if paid to third parties.

CARF held that the royalties remitted by the taxpayer to its related party located abroad should not be included in the goods' customs value, due to the lack of compliance with requirement (ii) above. In this case, the taxpayer imported inputs for the manufacturing process of the finished goods in Brazil. Considering that the royalties were related to transfer of technology and of know-how applicable in the manufacturing process, CARF decided that such values should not be deemed a sale condition imposed by the exporter in connection with the imported product.

3. IP Rights

In Brazil, there is a process for recording trademarks with customs authorities. The Brazilian National Directory of Trademarks for Combating Counterfeiting (the Directory) has been in force since December 2013. It is still in a test phase and, according to information provided by the officer of the Brazilian Patent and Trademark Office (INPI), there is no deadline for completion. No official border statistics were disclosed, but, according to INPI's officer, the Directory already contains specific contact information for over 70 trademark owners (which represents approximately 8,000 trademark registrations).

The Directory basically consists of a list of legal representatives appointed by trademark owners to assist the public authorities in combating counterfeiting and tax evasion. It brings together the owners of the trademarks and the public agents working for their protection.

Access to all Directory information, which will be managed by INPI itself, will be restricted to public agents from specific entities, as set forth in the Resolution #1 (e.g., the Ministry of Justice, the Internal Revenue Service, the Brazilian Federal Police, INPI and the Federal Public Prosecutors' Office).

Therefore, by means of the appointed contacts, the Directory will assist public agents to obtain samples, information, guidelines, statements, and other documents regarding original products, to commence police investigations in order to prevent commerce in counterfeit products, and to assist in the examination of counterfeit products seized or impounded by the public authorities. All such documents will also guide the public authorities when deciding whether to destroy, or otherwise dispose of, knock-offs.

Please note that with the Directory, it is possible to appoint and insert the contact information of the trademark owner's legal representatives/attorneys for anti-counterfeiting (which can differ from the IP agent responsible for the IP portfolio management). Therefore, with only one application, the trademark owner may appoint its legal representative/attorney for anti-counterfeiting for all its trademark registrations with INPI, which is more cost effective. Additional strategic information and documentation for each mark may be inserted concomitantly with the appointment, or separately.

It is possible to disclose and insert in the Directory: (i) information on means through which original products enter Brazil; (ii) information on entry routes into Brazil of counterfeited products; (iii) information for identification of original products; and (iv) comparisons between original and counterfeited products (including images of the products), among others. In sum, trademark owners may insert any information or documentation they deem relevant for combating anti-counterfeiting in Brazil. All such information and/or documentation must be provided in the Portuguese language.

4. Country-of-origin Marking

Brazilian customs legislation does not require articles of foreign origin imported into Brazil to be marked. Nonetheless, according to article 557, item VIII of the Customs Regulation, the country of origin is among the information that must be stated in the commercial invoice.

The non-preferential origin rules are provided by Resolution CAMEX No. 80/10 and take into consideration the "substantial transformation" criteria. In this context, the Resolution (Article 2º §2º) provides that the country of origin shall be the country where the goods were produced or where the last substantial transformation occurred. Substantial transformation shall be the transformation process that offers a new individuality to the product, characterized by a shift in its tariff code (i.e., a change of the first four digits of the tariff classification). In addition to that, article 2º, §3º of the Resolution provides that the exporting country will not be considered the country of origin in a case where the product results from a process that consists only of assembly, packing, fractioning, selection, classification, marking or dilution.

Canada

Importers of products in the luxury and fashion industry generally must adhere to the same rules that apply to all importers of goods into Canada. However, importers of luxury and fashion products are faced with certain unique challenges, given the nature of their imports. For example, imports of luxury and fashion products, such as apparel, footwear and handbags, are generally subject to the highest regular customs duty rates imposed by Canada. As a result, the Canada Borders Services Agency (CBSA) enforcement activity is regularly focused on imports of luxury and fashion products. At the time of writing, as has been the case for a number of years, CBSA has indicated that a verification (audit) priority is in place with respect to the valuation of apparel and footwear.

The tariff classification of apparel can often be a difficult exercise, requiring a thorough understanding of the composition of the fabric and other materials used to produce the apparel. In July 2014, CBSA announced that the tariff classification of apparel samples (and footwear valued at CAD$30 or more per pair) imported into Canada would be a verification priority. In addition, importers who are claiming preferential tariff treatment for apparel are required to apply complex rules of origin to determine whether the apparel originates under the applicable rules and therefore qualifies for preferential tariff treatment.

Consequently, it is important that importers of luxury and fashion products fully understand and comply with the Canadian customs requirements, so as not to be subject to assessments by CBSA. These can result in the imposition of additional duties, taxes, interest and penalties that can lead to a significant erosion of the profit margin with respect to the imported products.

1. Process of Importation

The Customs Act governs the administration and enforcement of Canada's customs laws. All goods imported into Canada must be reported to CBSA, and all applicable duties and taxes must be paid. The amount of customs duty payable will depend upon the tariff classification, origin and value of the goods, as determined for customs purposes.

Commercial importations of luxury and fashion goods will be subject to a VAT, known as the goods and services tax (GST), at the rate of 5 percent. The GST is calculated on the duty paid value of the imported goods: i.e., the value for duty of the imported goods, plus any applicable duty. GST registrants who use the imported goods in their commercial activities are entitled to claim the GST paid at the time of importation as an input tax credit on their GST returns.

a. Business Number – Importer/Exporter Account Number and Customs Brokers

All Canadian individuals or businesses importing on a commercial basis must obtain a business number and an import/export account, in order to report and account for their imported goods. CBSA uses this number to identify a business and to process customs accounting documents. Most importers of commercial goods retain the services of a licensed customs broker to prepare and file with CBSA, on behalf of the importer, the prescribed customs accounting documents.

b. Tariff Classification of Imported Goods

Canada's Customs Tariff is based on the international Harmonized System. This classification of goods under the Customs Tariff is used to determine the rate of duty that applies, for statistical purposes, and to determine if the goods being imported are subject to any prohibitions, restrictions, quotas, anti-dumping or countervailing duties.

The classification of apparel items can be quite complex and requires a complete understanding of the composition of the item. Since the Customs Tariff is based on the international Harmonized System, classification of a product imported into a country other than Canada will provide guidance as to how the product will be classified for Canadian purposes. However, importers should be aware that CBSA does not always agree with the classifications as determined for products imported into another country. When determining the classification of luxury and fashion products under the Customs Tariff, reference must be made to the Canadian legal notes contained in the Customs Tariff, as well as Canadian jurisprudence and guidance documents (e.g., CBSA "D Memoranda" and customs notices).

c. Tariff Treatment

Goods imported into Canada from most countries are entitled to MFN tariff treatment. There are, however, a number of preferential duty rates available, provided the goods in question meet prescribed rules of origin. For example, pursuant to NAFTA, goods that are imported into Canada from the U.S. and Mexico, and meet the NAFTA rules of origin, are entitled to be imported into Canada free of duty, provided certain documentation requirements are met. Canada has also implemented a number of additional FTAs, including with Chile, Costa Rica, Israel, Peru, the European Free Trade Association (Iceland, Liechtenstein, Norway and Switzerland), Colombia, Jordan, Panama and Honduras.

d. Valuation

Under the Customs Act, the value for duty of imported goods will primarily be the "transaction value" of such goods. The transaction value is the price actually paid or payable for the goods, subject to certain adjustments, when sold for export to Canada to a "purchaser in Canada".

There are a number of preconditions that must be met in order to use the transaction value method. If these preconditions are not met, or the transaction value method cannot otherwise be determined, one of the alternate valuation methods as set out in the Customs Act must be applied. A key precondition to the use of the transaction value is that if the vendor and purchaser are related, the importer can demonstrate that the relationship has not influenced the purchase price for the goods. CBSA has indicated that it will be flexible in the type of evidence an importer may present in order to demonstrate absence of influence on pricing, including the importer demonstrating absence of influence on the basis of any of the methods set out in the OECD report *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. Generally, if the price paid or payable has been determined in accordance with a *bona fide* transfer price study for sales between the related vendor and purchaser or an advance pricing arrangement, CBSA will accept that the relationship has not influenced the price paid or payable. However, CBSA will consider whether any adjustments should be made to the price paid or payable, in accordance with the Customs Act.

Under the transaction value method, once the price paid or payable has been determined, certain additions to and deductions from the price paid or payable are required. Of particular note for importers of luxury and fashion goods is the requirement to add to the price paid or payable, to the extent that such amounts are not already included in the price, the value of what are commonly referred to as "assists". These assists include goods and services that are supplied, directly or indirectly, by the purchaser of the goods free of charge, or at a reduced cost, for use in connection with the production and sale for export of the imported goods, and include materials, components, parts and other goods incorporated in the imported goods (which therefore includes fabric, zippers and buttons) and engineering, development work, art work, design work, plans and sketches undertaken elsewhere than in Canada and necessary for the production of the imported goods. Many importers of luxury and apparel goods do supply assists to the manufacturers of the product free of charge, or at a reduced cost, and these assists must be taken into account when determining the transaction value of these goods.

Another required addition to the price paid or payable under the transaction value method are royalty and license fees that the purchaser of the goods must pay to the vendor of the goods, directly or indirectly, as a condition of the sale of the goods for export to Canada. Based on Canadian case law, "unless a vendor is entitled to refuse to sell licensed goods to the purchaser or repudiate the contract of sale where the purchaser fails to pay royalties or licence fees", the royalties or licence fees are not paid as a condition of the sale for export and therefore are not dutiable. Furthermore, CBSA has indicated that, in order for the royalty or license fee to be dutiable, the commercial documentation between the parties must explicitly state that the vendor can refuse to sell the goods or repudiate the contract if the royalty or license fee is not paid. Therefore, while the dutiable status of royalty payments should always be considered, in the Canadian context the royalty and license fee payments often will not be dutiable, since it typically is the case that there is no explicit written requirement in the contract of sale that the vendor can repudiate the agreement or refuse to sell the goods if the royalty or license fee has not been paid.

In addition, many importers of luxury and fashion products make payments to related parties under management agreements, research and development agreements, cost sharing agreements and marketing and promotion agreements. In certain instances, these payments must be added to the price paid or payable for the imported goods, in that these payments are considered to be "subsequent proceeds". Careful consideration should be given to the dutiable status of these types of payments.

Unlike the U.S., Canada does not use the "first sale" rule for determining the value for duty of imported goods. Instead, Canada focuses on the value of the "last sale" before importation. Under the transaction value method, the value for duty is the price actually paid or payable for the goods, subject to certain adjustments, when sold for export to Canada to a "purchaser in Canada". The Valuation for Duty Regulations define "purchaser in Canada" in part as:

i. a resident;
ii. a person who is not a resident but who has a permanent establishment in Canada; or
iii. a person who neither is a resident nor has a permanent establishment in Canada, and who imports the goods, for which the value for duty is being determined,
    a. for consumption, use or enjoyment by the person in Canada, but not for sale, or
    b. for sale by the person in Canada, if, before the purchase of the goods, the person has not entered into an agreement to sell the goods to a resident.

"Permanent establishment" is defined as a "fixed place of business of the person and includes a place of management, a branch, an office, a factory or a workshop through which the person carries on business". A resident with respect to a corporation is defined as a "corporation that carries on business in Canada and of which the management and control is in Canada".

It is important for importers of luxury and apparel items to ensure that the "purchaser in Canada" requirements are considered, so that the correct transactions are reviewed in determining the price paid or payable for the imported goods under the transaction value method.

e. Corrections to Filed Customs Declarations

Importers who have "reason to believe" that a declaration of origin, tariff classification or value for duty is incorrect are required to amend the entries made to CBSA with respect to the relevant importations, and ultimately pay any additional duties, GST and interest owing. The correcting entries must be filed within 90 days of the "reason to believe" date. In general, the obligation to make a correction ends four years after the goods were accounted for.

Importers may correct each incorrect entry individually by filing the prescribed form (Form B2) with CBSA. However, where multiple entries require correction, the importer may request permission from CBSA to file "blanket corrections", whereby one Form B2 is filed with a supporting spreadsheet summarizing all the entries that are to be adjusted.

f. Retroactive Transfer Price Adjustments

The correction of entries is required where the imported goods are subject to retroactive transfer price adjustments. Where the retroactive transfer price adjustment results in an increase in the amount charged to the Canadian importer for the goods imported, it is clear that the importer must correct the entries subject to the adjustment within the 90 days prescribed by the Customs Act. At the time of writing, the position of CBSA is that where a retroactive transfer price adjustment reduces the amount paid by the importer of the goods, pursuant to paragraph 48(5)(c) of the Customs Act, the reduction is to be disregarded. However, CBSA's interpretation of paragraph 48(5)(c) may not be correct with respect to retroactive transfer price reductions, and CBSA is considering whether to change its current position. Importers of luxury and fashion products that are subject to high duty rates, and who have received credits from the vendors of the imported goods as a result of intercompany retroactive transfer price adjustments, should consider filing refund claims to recover the duty paid on the credited amounts. There is a four-year limitation period on filing refund claims.

2. Post-release Verifications

To ensure compliance with the customs regime in Canada and verify the information declared at the border, CBSA engages in "post-release verifications", i.e., audits, after goods are released by CBSA. There are a number of types of post-release verifications. Random post-release verifications occur when CBSA selects importers at random and are used by it to measure compliance and revenue loss. The results of the random verifications may lead to targeted post-release verifications, which are also referred to as national priority verifications. CBSA designates certain Harmonized System tariff codes as verification priorities, using a risk-based, evergreen process. New verification priorities may be added throughout the year.

With respect to luxury and fashion products, at the time of writing, CBSA has indicated that verifications of apparel and footwear are valuation national priorities (as they have been for a number of years), and verifications of apparel samples and footwear valued at CAD$30 or more are national priorities for tariff classification. Jewelry, cotton pants, and T-shirts are on the current list for national priority origin verifications.

CBSA can assess an importer for additional duties, GST, interest and penalties generally within four years from the date of entry.

3. Penalties

Where there have been contraventions of the Customs Act and its regulations, CBSA may impose civil penalties in accordance with its Administrative Monetary Penalties System (AMPS). CBSA regularly imposes AMPS penalties, which are assessed based on the contravention that was committed. Different contraventions are subject to different penalty amounts, depending on the severity of the contravention; penalty amounts are also typically graduated, according to the number of instances of a contravention. CBSA will usually impose AMPS penalties where it determines that the type (degree of intent), frequency, severity of the contravention, and importer's compliance history suggest that the importer's compliance with the requirements of the Customs Act is better achieved through the administration of AMPS penalties than through the criminal offense provisions of the Customs Act. AMPS penalties apply to errors that result in revenue loss but may also apply to non-revenue compliance errors. The maximum penalty for a single AMPS contravention is CAD$25,000; however, where there are multiple contraventions within one transaction, more than one penalty may be issued, resulting in an aggregate penalty for the transaction exceeding CAD$25,000.

Interest may be applied to amounts owing, calculated at one of two rates: the regular "prescribed rate" (which is based on the average annual rate of interest on 90-day treasury bills in the first month of the preceding quarter) and the "specified rate". The specified rate is a penal rate that is equal to the prescribed rate of interest plus six percentage points. Whether the specified rate or the prescribed rate applies, interest is compounded daily.

Seizures, ascertained forfeitures and criminal prosecutions apply to the most serious offenses.

4. Voluntary Disclosures

CBSA has implemented a Voluntary Disclosures Program that permits importers who have not made the required corrections to their origin, value and tariff classifications declarations within the 90-day time limit discussed above to voluntarily disclose these errors to CBSA. When making a voluntary disclosure, the importer will be required to file entries to correct the errors disclosed to CBSA, and pay all duties and GST owing. If a disclosure is accepted by CBSA as voluntary, the importer generally will be charged interest at the prescribed rate on the duties and GST owing; however, the importer will not be required to pay AMPS penalties and interest at the specified rate.

5. Country-of-origin Labeling

Pursuant to the Determination of Country of Origin for the Purposes of Marking (NAFTA Countries) Regulations (NAFTA Regulations) and the Determination of Country of Origin for the Purposes of Marking Goods (Non-NAFTA Countries) Regulations (Non-NAFTA Regulations), boots, shoes, handbags and purses, and most articles of clothing, are required to be marked with their country of origin to be imported into Canada. Pursuant to the Non-NAFTA Regulations, the country of origin of goods imported from a non-NAFTA country is the country in which the goods were "substantially manufactured". For goods imported from a NAFTA country, the NAFTA Regulations set out a relatively complex set of rules for determining the country of origin of these goods, including consideration of whether a prescribed change in tariff classification occurs and, in certain circumstances, determination of the country or countries of origin of the single material that imparts the essential character of the goods.

In addition, the regulations under the Textile Labelling Act (TLA) require that, if there is a representation that the article or any fabric or fiber therein is imported, the name of the country of origin must be shown on the mandatory disclosure label or on a separate label affixed or applied to the article. However, TLA does not require a person to disclose that an article is imported. For the purposes of TLA, the regulations define the country of origin as the country in which the textile fiber was grown or made, or the country in which a textile fiber product was substantially made. For goods imported from a NAFTA country, these requirements must be assessed in light of the NAFTA Regulations discussed above.

C. Asia Region

Singapore

1. Overview

The main relevant pieces of import and export legislation in Singapore are the Customs Act (Chapter 70) (Customs Act), and corresponding Customs Regulations and subsidiary legislation; and the Regulation of Imports and Exports Act (Cap. 272A*)* (RIEA).

The Regulation of Imports and Exports Regulations (RIER), made pursuant to RIEA, require that no goods be imported into, exported out of, or transshipped through Singapore without a permit. This requirement applies to *all* goods (whether controlled or uncontrolled) unless they fall within one of the specified exceptions. The permit referred to here is what is known as a "cargo clearance" permit, and must be obtained for every import into and export out of Singapore.

The limited exceptions to the mandatory requirement for a permit include that if the goods are not controlled imports, controlled exports or controlled transshipments and are:

- being imported, exported or transshipped by parcel post;
- trade samples, specimens for analysis or test, and gifts, the total value of which does not exceed S$400;
- goods being imported, by air, the total value of which does not exceed S$400; or
- goods being exported or transshipped by air, the total value of which does not exceed S$1,000.[56]

The relevant cargo clearance permits required under RIER can be obtained via TradeNet, a nationwide electronic data interchange system that allows various parties from the public and private sectors to exchange structured trade messages and information electronically. However, only Singapore-registered companies may apply for these cargo clearance permits via TradeNet.

2. Importing into Singapore

Import permits obtained via TradeNet are also referred to as "IN" permits. A company will have to obtain the import permits prior to the import of goods into Singapore for all four transport modes (rail, road, air and sea). Where the import concerns goods that are controlled, further authorization may be required from the relevant government agencies prior to import. Examples of such controlled imports that are relevant to the luxury and fashion industry include endangered species of wildlife and their by-products, tableware and kitchenware of porcelain or china, certain hair dyes and hair care products, as well as cosmetics and cosmetic products. [57]

3. Dutiable Goods vs. Non-Dutiable Goods at Import

Dutiable goods are subject to an "excise duty" in accordance with the Customs (Duties) Order. Broadly, dutiable goods include liquor, tobacco, motor vehicles and petroleum products. Excise duties are usually payable either ad valorem (i.e., a percentage of customs value: e.g., 20

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[56] Regulation of Imports and Exports Regulations, section 3.
[57] See the Singapore Customs website for a full list of controlled goods for imports.

percent for motor vehicles, including stretch limousines, and 12 percent for motorcycles) or at specific rates (e.g., S$88 per litre of alcohol).[58]

For non-dutiable goods, only GST (which is currently at 7 percent) is payable at the time of importation, unless the good is stored in a GST-free zone, or part of a zero GST scheme, such as the Zero GST Warehouse Scheme. However, note that GST will be payable when these goods are removed domestically from the GST-free zone.

4. Exporting Out of Singapore

Export permits obtained via TradeNet are also referred to as "OUT" permits. Singapore Customs recently implemented the Advance Export Declaration (AED) regime for all exports. The AED regime requires all declarations to be submitted before the goods, including non-controlled and non-dutiable goods, are exported from Singapore. In order to avoid penalties arising from late declarations, traders must ensure their supply chain systems are up to date, so that all export declarations are submitted either as soon as the information is available, prior to cargo arrival at sea ports, or prior to cargo lodgement with the ground handling agents.[59]

Additionally, for controlled goods, a company will be required to submit the export permit applications to the competent authorities for processing and approval before being able to export the controlled goods. Examples of such controlled exports include rough diamonds, Singapore-made textiles, and garments and textile articles for export to the EU or the U.S.[60]

5. Singapore's Voluntary Disclosure Program

The Voluntary Disclosure Programme (VDP) allows individuals or companies that voluntarily come forward in good faith to disclose errors made and/or omissions in relation to any customs offenses. The VDP is not meant to operate as an amnesty program, but instead seeks to encourage self-compliance by traders. In return, Singapore Customs will consider imposing a lower fine or even waiving the applicable penalties altogether.

However, the following eligibility criteria should be noted:

- disclosure must be voluntary;
- disclosure must be complete, with all relevant information pertaining to the errors and omissions; and
- disclosure must be made before notice or commencement of audit checks and investigations.

The disclosure can be in a form of a letter, fax, email, or a VDP form available from Singapore Customs. Applications should be accompanied by a permit, invoice, packing list, bill of lading or air waybill, and all other necessary supporting documents. There are specific disclosure requirements for non-compliance pertaining to the rules of origin under Singapore's FTAs.[61]

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[58] For detailed rates for the relevant item or product, please refer to the *Customs (Duties) Order.*
[59] For further details of the AED regime, please refer to the Singapore Customs website.
[60] Please see the Singapore Customs website for a full list of controlled goods for export.
[61] For specific requirements relating to non-compliance with the rules of origin under Singapore's free trade agreements, please refer to the Singapore Customs website.

In straightforward cases, the Singapore Customs' verification process will typically take between one to three months. However, the length of the processing period will also be subject to the magnitude and complexity of each VDP application. Singapore Customs also reserves the right to investigate further if it suspects that disclosure has been incomplete or inaccurate. When deciding on the penalty to be imposed, Singapore Customs will take into account that a voluntary disclosure has been made. Singapore Customs may also consider granting installment scheme arrangements for payment of penalties on a case-by-case basis.[62]

6. Penalties for Breach of Customs Act and RIER

a. Customs Act Breach

Penalties for a breach of the Customs Act vary in severity and are subject to Singapore Customs' discretion. Some examples of penalties upon conviction of an offense are set out below:

- Making an incorrect declaration:
  - A fine not exceeding S$10,000, or the equivalent of the amount of the customs duty, excise duty or GST payable, whichever is the greater amount, or imprisonment for a term not exceeding 12 months, or both.[63]
- Failure to comply with conditions imposed by Singapore Customs on removal of goods from Singapore Customs' control:
  - A fine not exceeding S$5,000.[64]
- Making a false declaration:
  - A fine not exceeding S$10,000 or imprisonment not exceeding two years, or both.[65]

b. RIER Breach

The potential penalties for non-compliance with RIER are more severe than penalties under the Customs Act. For example, a person who is guilty of an offense, such as importing, exporting or transshipping goods without a permit under the RIER (unless otherwise provided) shall be liable for:

- on the first conviction – a fine not exceeding S$100,000 or three times the value of the goods in respect of which the offense was committed, whichever is the greater, or imprisonment for a term not exceeding two years, or both; and
- on the second or subsequent conviction – a fine not exceeding S$200,000 or four times the value of the goods in respect of which the offense was committed, whichever is the greater, or imprisonment for a term not exceeding three years, or both.

Critically, conviction for such offenses may affect a company's trade compliance status, inhibiting its future ability to obtain permits to import and export its products.

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[62] For further details on the Singapore voluntary disclosure program, please refer to the Singapore Customs website.
[63] Section 128(1) of the Customs Act (Chapter 70).
[64] Section 27(1) of the Customs Act (Chapter 70).
[65] Section 28(1)(a) of the Regulations of Imports and Exports Act.

7. Preferential Tariffs and Preferential Origin Markings

Preferential tariffs are available for the export of Singapore-originating products to FTA partner countries under various FTAs. In order to claim preferential tariff treatment in the importing country, specific rules of origin must be satisfied. Such rules of origin will vary, depending on the FTA or preferential scheme in question, and hence need to be independently evaluated to ensure requirements are met or even to ensure exemptions are properly utilised. For example, under the Singapore–Australia FTA, raw materials that cannot be manufactured either in Singapore or Australia, and are imported, can be considered as a local raw material under the "Determined Manufactured Raw Material" scheme.

Generally, a preferential certificate of origin (PCO) will be required in order to claim preferential tariff treatment under an FTA. If a company is required to apply for a PCO, it will need to do this directly to Singapore Customs.[66]

8. Customs Valuation in Singapore

Customs valuation is a very big and increasingly complex area. Broadly, Singapore adopts the WTO Valuation Code. As such, the transaction value or the price paid/payable for the imported goods is the preferred means by Singapore Customs of determining the value of the goods for its purposes. However, if the transaction value cannot be used to determine the customs value, alternative methods of determination, including identical or similar goods value, deductive value, computed value and residual valuation, may be considered (in order of hierarchy).

9. IP Rights Enforcement

a. Overview

Under the Trade Marks Act (Chapter 332) and the Copyright Act of Singapore, Singapore Customs is the authority that oversees the enforcement of IP rights at the border, and has the power to detain suspected imports, exports and re-exports of IP-rights-infringing goods.

Brand owners may submit written notices to Singapore Customs if they suspect that a shipment of infringing goods will be coming into Singapore. Specifically, e.g., under the Copyright Act, a person who is the owner of copyrighted material may give the Director-General of Singapore Customs a written notice stating they have reason to believe infringing copies are expected to be imported into Singapore, substantiated by sufficient information for the Director-General to identify these infringing copies and ascertain when and where the infringing copies are expected to be imported.[67]

b. Recent Trends

Historically, customs enforcement in Singapore has not been particularly effective because, as outlined above, the notification regime is heavily reliant on the brand owners lodging a written notice to the Director-General of Singapore Customs, with specific details to identify infringing

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[66] Detailed steps in the process of application for a PCO can be found on the Singapore Custom's website.
[67] Section 140B of the Copyright Act.

goods: e.g., shipment details of the counterfeit goods, down to the exact container or vessel in which the infringing goods are (or are expected to be) stored.

Recently, however, as seen by the enforcement examples below, Singapore Customs has been taking notable steps to increase border enforcement, as part of a Singapore government-wide approach to combat trademark and copyright piracy. Singapore Customs works closely with the Intellectual Property Rights Branch of the Singapore Police Force, which enforces inland retail-level piracy.

c. Recent Customs Border IP Enforcement Examples

Some notable instances of recent Singapore Customs enforcement efforts include the detainment in April 2013 of over 30,900 counterfeit luxury bags, shoes, wallets, and other fashion items, upon receiving notification from one of the brand owners. This was followed in December 2013 by the detainment by Singapore Customs of over 78,000 counterfeit vodka bottles. More recently, in May 2014, Singapore Customs officers unsealed and inspected a container and found an assortment of toys, water bottles, bags and accessories featuring popular superhero and comic characters. The Intellectual Property Rights Branch of the Singapore Police Force was immediately notified, and even more trademark infringing goods were found at the offices of the importer.

d. Penalties for IP Breach

The penalties for intellectual property breaches in Singapore under the Trade Marks Act and the Copyright Act can be substantial. Under the Trade Marks Act, any person who imports into Singapore any goods to which a registered trademark is falsely applied shall be liable upon conviction to a fine not exceeding S$10,000 for each counterfeit good or thing (but not exceeding an the aggregate of S$100,000) or to imprisonment for a term not exceeding five years, or both.[68]

Similarly, under the Copyright Act, any person who, at a time when copyright subsists in a piece of work, imports into Singapore any article that he or she knows, or ought reasonably to know, to be an infringing copy of the work, for the purpose of selling, trading, exhibiting in public, or for distributing the product for any purpose to an extent that it will affect prejudicially the owner of the copyright in the work, will be guilty of an offense. The person will then be liable upon conviction to a fine not exceeding S$10,000 for each article infringing the copyright, or S$100,000, whichever is lower, or to imprisonment not exceeding five years, or both.[69]

Myanmar

The recent liberalisation of Myanmar's economy has led to substantial increases in its trade volumes. Authorities are working on improving the regulatory framework; however, for the time being, parties will find that knowing the constantly changing practices is more important than understanding out-of-date laws and regulations.

[68] Section 49(c) of the Trade Marks Act (Chapter 332).
[69] Section 136(2) of the Copyright Act (Chapter 63).

1. The Existing Legal Regime and Enforcement Trends

The primary pieces of legislation that govern trading in Myanmar include the Sea Customs Act 1878, Land Customs Act 1924, Tariff Law 1992 and Export and Import Law 2012. Violators of the provisions of these laws are subject to both criminal and civil penalties. The penalties available under these laws range from confiscation of traded goods to fines and a maximum of three years imprisonment.

It is difficult to gauge the applicability of penalties, as these will often depend on internal customs directives and notifications that are not publicly available. As far as we are aware, it is very rare for violators of the law to be prosecuted; normally, violations are settled by paying a fine, or goods getting confiscated.

If an importer or exporter becomes aware that they are in breach of any rules or regulations, they may self-disclose such a breach; however, under the publicly available laws, there are no voluntary self-disclosure procedures for violation of customs' regulations. Internal directives and regulations might provide for leniency, or other benefits, if a party submits a voluntary self-disclosure.

Compliance audits in Myanmar are usually carried out at customs checkpoints at the country's entry and exit points. The first step is the submission of a customs declaration form, together with supporting documentation. When the physical goods are passing through the customs channels at the port, they will be directed to either the green, yellow or red channel. There is no inspection at the green channel, but goods in the other channels will be x-rayed and cargo may be unpacked. Random mobile inspection teams may also inspect cargo.

2. Customs Valuations

In Myanmar, valuations are carried out by the customs department. It will normally use the cost insurance and freight (CIF) or FOB price for valuation purposes; for many items, it will also use pre-determined list prices, but, if such list values are not available, may inquire with retailers and wholesalers, or look up prices on the internet.

First sale prices and transfer prices are not used as a method of determining customs valuations.

In regard to determining the dutiability of royalty or licencing fees, there is currently no clear definition available. The general practice at the Internal Revenue Department is to classify all licencing fees as royalties.

3. Existence and Enforcement of IP Rights

With customs having no trademark recording system, there is a distinct lack of enforcement with regards to identifying and prosecuting counterfeits at the border. There is no law specifically prohibiting the import of counterfeit or gray market goods. There is a general restriction under the criminal law against infringing a trademark; however, we are not aware of there ever having been any enforcement under this provision.

In practice, the only action that can be taken to prevent the import of counterfeit goods is to negotiate directly with the importer.

4. Country-of-origin Markings

All imported and exported goods require country-of-origin markings. In certain circumstances, customs will also require a certificate of origin.

Vietnam

1. Points to Note from the Existing Legal Regime and Enforcement Trends

a. Civil and Criminal Penalties for Customs Violations

Violations in the field of customs procedures, customs inspection and supervision, customs control, and tariff evasion typically result in administrative penalties. Customs violations that are subject to administrative penalties include those relating to the following: time limits for customs declaration; customs declaration regulations; tariff declarations; custom inspection and tariff audit; customs surveillance; customs control; and tariff evasion. Each violation results in different amounts of fines, ranging from VND500,000 to VND100,000,000 (approximately US$23 to US$4,761). An incorrect customs declaration leading to a tax payment shortage will be subject to an administrative penalty of 10 to 20 percent of the shortage. Tax evasion, which is not yet subject to criminal penalties, will be subject to an administrative penalty of one to three times the evaded tax amount.

Tariff evasion amounting to VND100,000,000 and above may lead to criminal consequences. Tariff evasion amounting to less than VND100,000,000 may still result in criminal penalties, if the importers were previously subject to administrative penalties due to tax evasion, prior to committing the current tariff evasion. The criminal penalties for tariff evasion may include up to seven years imprisonment, along with fines of up to triple the amount of tariff evasion. Vietnamese law imposes criminal penalties only upon natural persons.

The statute of limitations on administrative penalties applied to most violations is two years, except for administrative penalties applicable to an incorrect customs declaration leading to a tax payment shortage or tariff evasion, for which the statute of limitations is five years.

For criminal penalties applied to tariff evasion, the statute of limitations is 10 years.

b. Current Enforcement Climate

Vietnam has conducted various customs reforms, such as promulgating the new customs law, which came into force on 1 January 2015; modernizing customs management practice by launching a new e-customs system, the VNACCS/VCIS, to simplify customs clearance procedures; reducing the clearance time; and enhancing the management capacity of customs authorities.

The key point in customs enforcement is having a strong risk management system. As a member of the WTO Trade Facilitation Agreement, Vietnam is obliged to adopt rules and measures so that customs enforcement shall facilitate the movement of goods. Toward that, customs management and enforcement focus on post-clearance inspection with respect to valuation, classification and certificates of origin.

Self-disclosure and Audit Mechanism

Importers can make voluntary self-disclosures for the purpose of minimizing administrative penalties that may arise if the customs authorities detect an error. The administrative sanctions will vary, based on the timing of voluntary self-disclosure, as follows:

Time of voluntary disclosures	***Administrative sanctions***
Amending customs declaration or supplementing customs declaration upon conducting customs procedures, but before the customs authorities carry out physical inspections	Late payment interest (if any)
Supplementing customs declaration after the completion of the customs procedures, but within 60 days from the date of customs registration and before the post-customs clearance audit	Late payment interest
Supplementing customs declaration after 60 days from the date of customs registration and before the post-customs clearance audit	Late payment interest and 10% penalty of the tax amount in shortage

Customs authorities may conduct post-clearance audits on importers for the purpose of customs management and enforcement. The statute of limitations for post-clearance audits is five years from the date of the customs declaration form. Post-clearance audit shall mainly focus on the import/export activities conducted by the importer during a certain period of time. The post-clearance audit may be conducted at the office of the customs authorities, whereby the customs authorities will check documents submitted by the importer at the time of the customs declaration; or at the importer's premises, whereby the customs authorities may check more broadly.

The customs authorities may also conduct tax audits against importers if there are apparent and serious signs of tariff evasion.

2. Points on Customs Valuation and Pricing

There is no "first sale rule" in Vietnam. In principle, the dutiable value of imported goods must be first determined based on the transaction value. The transaction value is the price actually paid or payable to the seller for the purchase of imported goods, subject to certain adjustments.

Where the transaction value method cannot be applied, the following five methods will be used, in the following order of application:

- transaction value of identical imported goods;
- transaction value of similar imported goods;
- deductive value;
- computed value; and
- fall-back value.

In Vietnam, customs valuation and transfer pricing are managed independently, with customs valuation being the responsibility of the customs authorities, and transfer pricing being the responsibility of the tax authorities. Therefore, prices that are adjusted under transfer pricing regulations cannot be used for the purpose of customs valuation adjustments, and vice versa.

Further, the payment of royalties and license fees related to imported goods that are paid either directly to offshore sellers or indirectly to other offshore entities under various scenarios as a condition of sale will be dutiable. For instance, payments for the rights to use a trademark related to goods that are imported and then resold in Vietnam as they are, or then resold in Vietnam after undergoing processing, will be dutiable. Payment for rights to use technical secrets to produce imported goods will be dutiable.

3. Enforcement of IP Rights (IPR) at the Border

Trademark owners or their authorized persons (trademark owners) have the right to file with the customs authorities an application for suspending customs procedures for imports or exports suspected of infringing their IPR. Trademark owners can file the application for a suspension request for the duration of a specific case or for the duration of one year. The customs authorities will review the application dossier and issue a notification of acceptance of the suspension request within the following time periods: (i) in the case of suspension requests for the duration of a specific case, within 24 working hours after the receipt of the completed application dossier from the trademark owners; or (ii) in the case of suspension requests for the duration of one year, within 30 days from the receipt of the complete application dossier from the trademark owners. From the date that the customs authorities accept such a suspension request, the IPR information, as stated in the application dossier, will be recorded at the specific customs authority where the trademark owners filed the application.[70]

When customs authorities detect at the border gate that goods are infringing an IPR, they will suspend the customs procedures for the import/export of such goods. The customs authorities will then notify the trademark owners about the suspected case, and will request that the trademark owners pay a security fee (in order to secure the payment of damages for the goods owner, and other expenses that may be incurred due to improper suspension of customs procedures). After the trademark owners pay the security fee, the customs authorities will issue a decision to suspend the customs procedures for the import/export of such goods. The suspension period will last for 10 working days and can be extended by 10 more working days. The trademark owners must, within the suspension period, provide evidence proving that the goods that are suspended for customs procedures are counterfeit.[71] If the goods are proved to be counterfeit, such goods may be seized by the customs authorities, or the goods owner may be subject to administrative sanctions or criminal sanctions, depending on the goods owner's breach of the regulation.[72]

[70] Decree No. 154/2005/ND-CP, articles 48 and 49.
[71] Decree No. 154/2005/ND-CP, articles 50, 51, 53.
[72] Decree No. 127/2013/ND-CP, article 19; Criminal Code, Article 156.

4. Existence of Country of Origin Marking

Requirements for origin marking apply to imported and exported goods. The customs authorities may physically inspect imported and exported goods to check whether the goods have the appropriate origin marking corresponding with the origin stated in the customs declaration.[73] Under the current regulations, the term “origin of goods” is defined as “the country or territory where the goods were entirely manufactured, or in the case of goods for which a number of countries or territories participated in the manufacturing process where the final, fundamental processing stage was implemented.”[74] In order to determine eligibility for preferential duty treatment or non-tariff treatment under FTAs between Vietnam and other countries or regions (e.g., the Association of Southeast Asian Nations (ASEAN)), rules of origin will be determined in accordance with each specific relevant agreement.

Indonesia

There is no specific customs treatment for importation of luxury goods in Indonesia. The procedure and provisions regarding importation of these type of goods are similar to those for other, general, importation. Further, one of the basic principles of importation in Indonesia is that the imported goods must be brand new: i.e., never been used.

1. Customs Enforcement and Sanctions

The sanctions that can be imposed in relation to import and export depend on the type of violation of the regulations. Below is some information on customs sanctions, which may be relevant to the luxury and fashion industry:

- There is a mandatory labeling requirement for goods that are listed under the prevailing regulations on labeling (depending on the Harmonized System Codes). As far as we are aware, certain types of goods manufactured by the luxury and fashion industry (e.g., leather products and clothes) are subject to this mandatory labeling requirement, and, under the Trade Law, violation of this requirement is punishable with imprisonment of up to five years and/or monetary fines of up to Rp5,000,000,000.
- Under the Customs Law, for both import and export, smuggling activities are subject to (i) imprisonment of one to 10 years; and/or (ii) monetary fines of up to Rp50,000,000-5,000,000,000. Further, any violation affecting the national economy has a penalty of imprisonment of five to 20 years and/or monetary fines of Rp5,000,000,000-100,000,000,000.
- Parties who falsify customs declarations or give wrong information, either verbal or written, will be subject to imprisonment for two to eight years and/or monetary fines in the amount of Rp50,000,000-1,000,000,000.
- There is a blanket prohibition against the import of non-new products and, under the new Trade Law, there is a criminal penalty for violating this prohibition of up to five years imprisonment or fines of up to Rp5,000,000,000.

[73] Decree No. 154/2005/ND-CP, article 8, Article 11.
[74] Decree No. 19/2006/ND-CP, article 3.1.

2. Customs Valuation

Indonesia adopts a self-assessment method for customs valuation and classification, and it follows the WTO standards for customs valuation and classification.

Under prevailing laws and regulations on customs valuation, the primary basis for customs value is “transaction value”. The transaction value is defined as the price that is really paid, or must be paid, by a buyer to the seller related to the goods to be imported into the customs area, plus costs and/or values that must be added to a transaction value (e.g., royalty and proceeds), as long as the costs and/or values are not yet included in the price that is really paid or must be paid.

Under regulation 160, royalties and licenses are added to customs value, as long as they are: (i) paid by the buyer directly or indirectly; (ii) a condition of the sale of the imported goods; and (iii) related to the imported goods. For instance, if the imported goods have, during the importation, reflected/consisted of a brand, then these imported goods will be deemed to have royalties to be added to the customs value.

If the customs value for the calculation of import duty cannot be determined based on transaction value, then the customs value should be determined sequentially, based on the following: (i) transaction value of identical goods; (ii) transaction value of similar goods; (iii) deduction method; (iv) computation method; or (v) fallback method.

The customs authority can always make a reassessment to determine another customs value that it deems more fit and appropriate, within two years (according to the statue of limitation) after the submission of the import declaration. If there is a reassessment of the customs value, it will include a test of the reasonability of the customs value declared in the import declaration. The reasonability test can be by way of comparing the price of goods declared in the import declaration with the customs database. The customs value will be deemed reasonable/appropriate if the test shows that the customs value declared is: (i) not less than 5 percent lower than the price of identical goods in the customs database; (ii) 5 percent lower than the price of identical goods in the customs database; (iii) equal to the price of identical goods in the customs database; or (iv) greater than the price of identical goods in the customs database.

3. Customs Audit

Generally, the customs audit will be commenced three months after the issuance of the assignment letter to the audit team. The audit team will request the audit data from the auditee and, seven days after the request, the auditee must provide the requested data. The audit team will further assess such audit data, by using a sampling audit method, and issue a temporary finding, to be responded to further by the auditee. After further discussion and assessment by the audit team, it will issue the audit result.

The current trend is that the findings from the general customs audit are mainly related to (i) dutiability of royalty payment; and (ii) product classification.

4. Enforcement Action Against Counterfeit Goods

In Indonesia, there is no process for recording of trademarks with the customs authority. However, in 2012, Supreme Court Regulation No. 4 of 2012 on Temporary Suspension Orders, which provides guidelines for the customs office to suspend the release of possibly infringing goods from the customs zone, as earlier regulated under the prevailing customs law, was issued.

To file a request for a temporary suspension order, a trademark owner must submit the following evidence and documents to the Commercial Court:

i. proof of trademark rights;
ii. sufficient preliminary evidence indicating that there is a trademark infringement;
iii. clear descriptions of the exported or imported goods, including the number of the bill of lading or airway bill, the number of the carrier, the types and the amount of goods, destination harbor and originating country; and
iv. payment of deposit, cash or bank guarantee, in an amount equal to the expected value of the counterfeit products and also the consequential fees that might arise from the temporary suspension order.

After the issuance of a temporary suspension order by the Commercial Court, the trademark owner should inform the Customs Office, so that it can implement the suspension of the release of goods from the customs zone, and notify in writing the importer/exporter or the owner of the goods being suspended.

The suspension period will be valid for 10 days, in which the trademark owner may inspect the imported or exported goods, under the supervision of the customs office and in the presence of the court bailiffs. Once the trademark owner confirms that the imported or exported goods infringe its trademark rights, it may commence legal proceedings, either civil or criminal. The trademark owner is obliged to file a report to customs stating that it has commenced civil or criminal action.

A check with the Commercial Court and customs has shown that, it seems, no party has yet applied for a temporary suspension order.

5. Existence of Country-of-origin Marking

Generally, the country-of-origin information is integrated with the labeling requirement. With regard to the marking, the provision will vary depending on the types of goods. For example, the minimum fineness standard of precious metals is stipulated under the Indonesian National Standard (SNI) guideline issued by the National Standardization Agency of Indonesia (BSN).

Philippines

Two recent developments have greatly impacted importers.

In June and July 2014, the Bureau of Customs (BOC) and the Bureau of Internal Revenue (BIR) issued a series of memoranda that, simply put, made it more difficult for legitimate importers to be accredited as importer. Without such accreditation, an importer will not be able to file the import entry and obtain release of the goods from customs custody. Importers and industry associations protested, as a lot of them will have to wait for months to be accredited.

The second development, which was probably largely unnoticed by business, is the issuance by the Department of Finance (DOF) in June 2014 of the Post Entry Audit Guidelines. The guidelines delineate the authority of DOF’s Fiscal Intelligence Unit (FIU) to conduct a post-entry audit and direct the Commissioner of Customs to immediately act on the findings of FIU. Similarly, the Commissioner of Internal Revenue is directed to act on the findings, in accordance with the provisions of the Tax Code.

1. Importer Accreditation

In order to engage in importation in the Philippines, a company must secure an Importer Clearance Certificate (ICC) from BIR and a Certificate of Accreditation from BOC. The ICC must be secured from BIR before filing the application for accreditation with BOC. This is to ensure that the company applying for accreditation with BOC has no outstanding tax liability arising from a tax assessment or unpaid delinquent account that is considered final, executory, and demandable.

To obtain an ICC from BIR, an application must be filed with its Accounts Receivable Monitoring Division, with the following supporting documents:

i. original copy of the Secretary's Certificate of the minutes/contents of the board resolution authorizing the designated representative to sign the application form;
ii. certified true copy of the registration with the Philippine Securities and Exchange Commission (SEC) and articles of incorporation;
iii. certified true copy of latest General Information Sheet filed with SEC;
iv. original copy of the Certificate of Good Standing issued by SEC;
v. original copy of the profile of the company;
vi. original copy of the profile of each member of the board and corporate officers;
vii. original copy of the personal profile of employees, representatives or agents dealing with BOC;
viii. certified true copy of the latest BIR Certificate of Registration (COR) of the head office of the applicant, and the COR of each branch or facility (if any);
ix. authenticated copy of the latest annual income tax return filed, together with audited financial statements and other prescribed attachments, if applicable;
x. certified true copy of the latest Mayor's Business Permit issued by the Local Government Unit (LGU) where the applicant's head office is registered;
xi. certified true copy of the contract of lease;
xii. vicinity map, location plan and photographs of the registered address of its head office indicated in the COR;
xiii. photocopy of latest utility bills (e.g., electricity, water, telephone) indicating the registered address of its head office in the COR, and indicating the name of the applicant (if the head office is owned) or the name of the lessor/sub-lessor (if the head office is leased);
xiv. undertaking to comply with the duty to preserve and maintain records for a period of 10 years and to allow access to examination by BIR, BOC and FIU;
xv. if applicable, the Certificate of Registration issued by the Board of Investments (BOI), Philippine Economic Zone Authority (PEZA) or the relevant investment promotion agency;
xvi. for companies newly registered with BIR, or one that was never accredited by BOC as either importer or broker, printer's delivery receipt and proof of filing of tax returns through BIR's electronic filing and payment system (EFPS). Please note that taxpayers applying for ICC are now required to register with BIR's EFPS; and
xvii. photocopy of the official receipt for the payment of the BIR accreditation processing and certification fee.

Please note that BIR requires that the documents submitted for the application are either originals or certified true copies of the originals.

After obtaining the ICC from BIR, the company shall be allowed to file an application for accreditation with BOC, upon submission of the following documents with the Account Management Office (AMO):

i. original or certified true copy of the ICC issued by BIR;
ii. list of expected imports, with clear descriptions in both technical and tariff terms, including estimated volume and values for the coming 12 months (in case the list of expected imports includes regulated items, the corresponding accreditation/license/permit from the relevant government agency shall also be submitted);
iii. sworn undertaking to accept notice by electronic mail, and to strictly abide with existing rules and regulations on the statement of full description of imported articles covered by entry declarations;
iv. Corporate Secretary's Certificate or Special Power of Attorney for Designated Signatories (with sample original signatures) in the import entries;
v. two valid government identification documents (IDs) with a picture of the applicant. The government IDs accepted by the BOC AMO are as follows:
    a. passport;
    b. driver's license
    c. social security system or government service insurance system ID;
    d. Professional Regulation Commission ID;
    e. unified multi-purpose ID; or
    f. Integrated Bar of the Philippines ID.
vi. printed Client Profile Registration System (CPRS) application profile from an accredited value-added service provider (VASP) and printed email notification of "STORED" CPRS profile;
vii. National Bureau of Investigation ("NBI") clearance of the applicant issued within the last three months prior to the date of application for accreditation;
viii. certified true copy of the latest General Information Sheet filed with SEC;
ix. company profile, with pictures of the office premises and warehouse/storage facilities;
x. personal profiles of the applicant and responsible officers;
xi. previous Certificate of Accreditation, if applicable; and
xii. official receipt evidencing payment of processing fee.

Based on BIR Revenue Memorandum Order No. 10-2014, as amended, the BIR Accounts Receivable Monitoring Division ("ARMD") shall, as far as practicable, process the application for a ICC within 15 working days from acceptance of the application form and complete supporting documents. Similarly, according to Customs Memorandum Order No. 11-2014, the BOC AMO shall process the application for accreditation within 15 days from submission of the application and complete supporting documents. However, in our experience, the processing of the ICC and the BOC accreditation takes at least four months, due to the volume of applications pending with both BIR and BOC.

2. Customs Audit Procedure

BOC used to have a Post Entry Audit Group (BOC PEAG), tasked to investigate and audit the importation records of companies, to check their compliance with customs laws and regulations.

Pursuant to Executive Order No. 155, series of 2013, DOF issued Department Order No. 13-2014, which transferred the functions of BOC PEAG to FIU.

On 17 June 2014, DOF issued the Post Entry Audit Guidelines (Department Order No. 44-2014). Below is a summary of the guidelines and procedure in the performance by FIU of the audit examination, inspection, verification and/or investigation of transaction records of importers under the new Post Entry Audit Guidelines.

a. Importer and Import Selection

Through a computer-aided risk management system, FIU shall identify entities and transactions to be subjected to post-entry audit, based on objective and quantifiable data, including but not limited to existing independent studies and information on imported products determined to have a high risk of being subject to erroneous classification, misdeclaration or undervaluation; relative magnitude of customs revenue from certain imported products; rates of duties of the imports; compliance track record of the importer; and assessment of the risk to revenue of the importer's import activities. Upon selection of the importers and import entries, FIU may analyze whether there exists a potential valuation, classification and/or other compliance issue.

b. Coordination with BIR

FIU shall inform BIR of the selection of the importer and the grounds for the selection. BIR may issue a letter of authority (LOA) to investigate and examine the importer's records and books of accounts for any deficiency taxes.

c. Notice of Post-Entry Audit Findings

Upon determination by FIU of any deficiency in the duties declared and paid on importation, it shall notify the importer concerned by sending post-entry audit findings (PEAF) to the importer's address stated in the import entry filed with BOC. The PEAF to be issued shall state the specific import transactions covered; amount of deficiency duties found thereon; basis of the findings; and a notice that the findings of deficiency duties shall be submitted to BOC and BIR, unless said deficiencies are satisfactorily explained by the importer. The importer shall be allowed to submit relevant supporting documents.

d. Single Comprehensive Reply to PEAF

Within a non-extendible period of 30 calendar days from receipt of the PEAF, the importer may file one reply, sworn under oath, with FIU. The reply shall state whether the importer admits, or disagrees with, each of the findings in the PEAF. In the case of disagreement, the importer shall state all reasons for it. The reply to PEAF shall be executed by the importer personally if a natural person, by any authorized partner if a partnership, or by a duly authorized officer if a corporation.

e. Strictly No Contact Policy

Under no circumstance shall FIU hold a conference with the importer or broker, or any of the importer's or broker's officers, agents or representatives, regarding any finding stated in the PEAF. Any official or employee of FIU found to have committed a violation of this provision shall be held administratively liable, without prejudice to any civil or criminal proceedings that may be filed against such erring officer or employee.

f. Notice of Acceptance of Explanations

If FIU finds all explanations stated in the reply to PEAF satisfactory, it shall notify the importer that it accepts the explanations, and furnish BOC and BIR with copies.

g. Final Audit Report and Recommendation (FARR)

FIU shall submit the FARR to BOC and/or BIR, as the case may be, where the importer admits the findings in the PEAF; where explanations contained in the reply to PEAF are not satisfactory; or where no reply to the PEAF is filed within the prescribed period. The FARR shall include a recommendation on the administrative fines and penalties to be imposed on the importer.

h. Investigation of Broker

If upon review of all the documents submitted by the importer, and such other documents as may be available to FIU, there is *prima facie* evidence that the broker committed violations of the Tariff and Customs Code of the Philippines (TCCP) in relation to the transactions under consideration, it may also submit to BOC a report on its findings, with appropriate recommendations.

i. Assessment and Collection

i. Within five days from receipt of the FARR, the Commissioner of Customs (CoC) shall issue a collection letter directing the importer to pay, within 10 working days from receipt, the deficiency duties admitted, and the appropriate fines and penalties; and/or a formal assessment of deficiency duties and demand letter directing the importer to pay, within 10 working days from receipt, the deficiency duties not admitted, and the appropriate fines and penalties.

Any person who, after being subjected to a post-entry audit, is found to have incurred deficiencies in duties and taxes paid for imported goods, shall be penalized according to three degrees of culpability (section 3611 of the Tariff and Customs Code):

- *Negligence* – When a deficiency results from an offender's failure, through an act or acts of omission or commission, to exercise reasonable care and competence, to ensure that a statement made is correct, it shall be determined to be negligent and punished by a fine of not less than one-half but not more than two times the revenue loss;
- *Gross negligence* – When a deficiency results from an act or acts of omission or commission done with actual knowledge or wanton disregard for the relevant facts, and with indifference to or disregard for the offender's obligation under the statute, it shall be

determined to be grossly negligent and punished by a fine of not less than two and a half but not more than four times the revenue loss;

- *Fraud* – When the material false statement or act in connection with the transaction was committed or omitted knowingly, voluntarily and intentionally, as established by clear and convincing evidence, it shall be determined to be fraudulent and punished by a fine of not less than five times but not more than eight times the revenue loss, and imprisonment of not less than two years but not more than eight years.

ii. Within five days from receipt of the FARR, the Commissioner of Internal Revenue (CIR) shall act on the findings stated in the FARR, in accordance with the provisions of the Tax Code.

j. Failure to Pay Deficiency Duties

In the case of failure to pay the deficiency duties and penalties within the period prescribed, CoC shall immediately revoke, cancel and withdraw the accreditation privileges granted to the importer, and avail itself of administrative and judicial remedies provided for by the law, rules and regulations.

k. Failure to Pay Deficiency Taxes

In the case of failure to pay deficiency taxes and penalties as may be assessed by BIR, CIR shall take appropriate action, in accordance with the provisions of the Tax Code. CIR shall also inform CoC of such failure to pay deficiency taxes and penalties. CoC shall then immediately impose the same sanctions as in the case of failure to pay deficiency duties.

l. Authority to Compromise

CoC shall not be precluded from exercising its powers to compromise, subject to the approval of the Secretary of Finance, the imposition of the appropriate fines and surcharges on the deficiency duties provided for under section 2316 of TCCP.

m. Appeal to the Court of Tax Appeals (CTA)

Under the Revised Rules of CTA, a party adversely affected by a decision or ruling of CoC may appeal to the court by petition for review filed within 30 days after receipt of a copy of such decision or ruling. Thus, the importer may appeal the decision of CoC to CTA by filing a petition for review within 30 days upon receipt of the collection letter and/or FAAR.

Should CTA at the division level (CTA Division), issue a decision that is unfavorable to the importer, the importer may file a motion for reconsideration within 15 days from receipt of the notice of decision.

If the motion for reconsideration is denied by CTA Division, the importer may appeal by filing a petition for review with CTA En Banc within 15 days from receipt of the resolution. If CTA En Banc decides against the importer, the importer may file a motion for reconsideration within 15 days from receipt of the notice of decision.

Finally, if the motion for reconsideration is denied by CTA En Banc, the importer may elevate the case to the Supreme Court, by filing a petition for review on certiorari with the Supreme Court within 15 days from receipt of the resolution of CTA En Banc.

3. Voluntary Disclosure Program (VDP)

The VDP was established under Customs Administrative Order (CAO) 05-2007 and implemented by Customs Memorandum Order (CMO) No. 18-2007. It provides importers with a remedy to correct, under certain conditions specified therein, any erroneous, inaccurate or insufficient information declared to customs arising from sheer mistake, inadvertence, or negligence, without the imposition of any fine or penalty in appropriate cases. The VDP will not apply when the wrong entry declaration was attended with fraud, as defined in section 3611 of TCCP.[75]

The VDP has also been utilized to revise valuations used in previous importations, when there is a transfer pricing adjustment. While transfer pricing adjustments were probably not contemplated in the VDP regulations, the lack of any other available mechanism has made the use of the VDP desirable from the point of view of both BOC and the taxpayer/importer.

a. VDP Process

The VDP involves a five-step process, as follows:

i. *Filing of a VDP application form with PEAG* – The importer shall complete VDP application Form B. When the applicant is a corporation, the application shall be supported by a company board resolution authorizing the signatory in the application form to make the disclosure and to bind the company thereto.[76]

ii. *Payment* to the cash division of the collection district, which shall issue the corresponding Bureau of Customs Official Receipt ("BCOR") – The importer shall pay, by way of a manager's cashier's cheque, the disclosed amount indicated in the voluntary disclosure to the cash division of the appropriate BOC collection district.

iii. *Submission of VDP application and BCOR to the Special Verification Unit (SVU) of PEAG* – The application form, together with the BCOR and other supporting documents, must be filed with PEAG.

iv. *Processing of VDP application by PEAG and recommendation for the Customs Commissioner's approval/disapproval* – The duly completed application form shall be assigned to a PEAG officer for verification of the auditee's compliance with the provisions of CMO 18-2007. Upon completion of all the requirements for the VDP, PEAG shall evaluate and validate the submitted documents.

v. *Issuance of a letter of appreciation/denial by the Customs Commissioner* – The approved VDP application shall be returned to the Assistant Commissioner of PEAG for implementation.

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[75] Section II(B) of CAO No. 005-07, dated 24 May 2007.
[76] Section III(3) of CMO No. 018-07.

b. Benefits of the VDP

Should the importer/auditee choose to avail itself of the VDP, it may benefit as follows:

- No fine or penalty shall be imposed on the deficiency in duties and taxes but only to the extent of the amount and the issues disclosed.
- The applicant shall earn a "least priority status"[77]" in the annual audit selection process for all its auditable importations, subject to the following conditions:
  a. submission by the applicant of a customs compliance program designed specifically to address the cause or causes of the errors or mistakes made in the entry declarations as disclosed, and generally to enhance the level of competence of its personnel, agents, or officers in charge of its import clearance operations;
  b. compliant behavior established through random sampling and review of future import activities showing faithful and serious implementation of its customs compliance program; and
  c. the amount of the voluntary disclosure payment being not less than PHP1,000,000.00 per application.[78]

The procedure discussed above was based on the old rules, where an application for the VDP was filed with the BOC PEAG. However, BOC PEAG has been abolished, and neither DOF nor BOC has yet issued any new rules or guidelines for the processing of VDPs.

4. Penalties for Customs Violations in General

TCC provides for both civil and criminal penalties. In cases of undervaluation, misclassification or misdeclaration, the following penalties are imposed:

> SECTION 2503. Undervaluation, Misclassification and Misdeclaration in Entry. – When the dutiable value of the imported articles shall be so declared and entered that the duties, based on the declaration of the importer on the face of the entry, would be less by ten percent (10%) than should be legally collected, or when the imported articles shall be so described and entered that the duties based on the importer's description on the face of the entry would be less by ten percent (10%) than should be legally collected based on the tariff classification, or when the dutiable weight, measurement or quantity of imported articles is found upon examination to exceed by ten percent (10%) or more than the entered weight, measurement or quantity, a surcharge shall be collected from the importer in an amount of not less than the difference between the full duty and the estimated duty based upon the declaration of the importer, nor more than twice of such difference: Provided, That an undervaluation, misdeclaration in weight, measurement or quantity of more than thirty percent (30%) between the value, weight, measurement, or quantity declared in the entry, and the actual value, weight, quantity, or measurement shall constitute a prima facie evidence of fraud penalized under Section 2530 of this Code: Provided, further, That any misdeclared or undeclared imported articles/items

[77] "Least priority status" means that the importer may not be considered for audit selection for two years from the date of application.

[78] Section IV of CAO No. 018-07, 6 July 2007.

> found upon examination shall ipso facto be forfeited in favor of the Government to be disposed of pursuant to the provisions of this Code.
> *When the undervaluation, misdescription, misclassification or misdeclaration in the import entry is intentional, the importer shall be subject to the penal provision under Section 3602 of this Code.* [italics added].

Section 3602 of TCC states that:

> (a)ny person who makes or attempts to make any entry of imported or exported article by means of any false or fraudulent invoice, declaration, affidavit, letter, paper or by any means of any false statement, written or verbal, or by any means of any false or fraudulent practice whatsoever, or knowingly effects any entry of goods, wares or merchandise, at less than true weight or measure thereof or upon a false classification as to quality or value, or by the payment of less than the amount legally due, or knowingly and willfully files any false or fraudulent entry or claim for the payment of drawback or refund of duties upon the exportation of merchandise, or makes or files any affidavit abstract, record, certificate or other document, with a view to securing the payment to himself or others of any drawback, allowance, or refund of duties on the exportation of merchandise, greater than that legally due thereon, or who shall be guilty of any willful act or omission shall, for each offence, be punished in accordance with the penalties prescribed in the preceding section [section 3601].

Section 3601, in turn, provides:

> SECTION 3601. Unlawful Importation. – Any person who shall fraudulently import or bring into the Philippines, or assist in so doing, any article, contrary to law, or shall receive, conceal, buy, sell, or in any manner facilitate the transportation, concealment, or sale of such article after importation, knowing the same to have been imported contrary to law, shall be guilty of smuggling and shall be punished with:
>
> 1. A fine of not less than fifty pesos nor more than two hundred pesos and imprisonment of not less than five days nor more than twenty days, if the appraised value, to be determined in the manner prescribed under this Code, including duties and taxes, of the article unlawfully imported does not exceed twenty-five pesos;
> 2. A fine of not less than eight hundred pesos nor more than five thousand pesos and imprisonment of not less than six months and one day nor more than four years, if the appraised value, to be determined in the manner prescribed under this Code, including duties and taxes, of the article unlawfully imported exceeds twenty-five pesos but does not exceed fifty thousand pesos;
> 3. A fine of not less than six thousand pesos nor more than eight thousand pesos and imprisonment of not less than five years and one day nor more than eight years, if the appraised value, to be determined in the manner prescribed under this Code, including duties and taxes, of the article unlawfully imported is more than fifty thousand pesos but does not exceed one hundred fifty thousand pesos;
> 4. A fine of not less than eight thousand pesos nor more than ten thousand pesos and imprisonment of not less than eight years and one day nor more than twelve years, if the appraised value to be determined in the manner prescribed under this Code,

including duties and taxes, of the article unlawfully imported exceeds one hundred fifty thousand pesos;

5. The penalty of prision mayor shall be imposed when the crime of serious physical injuries shall have been committed and the penalty of reclusion perpetua to death shall be imposed when the crime of homicide shall have been committed by reason or on the occasion of the unlawful importation.

In applying the above scale of penalties, if the offender is an alien and the prescribed penalty is not death, he shall be deported after serving the sentence without further proceedings for deportation. If the offender is a government official or employee, the penalty shall be the maximum as hereinabove prescribed and the offender shall suffer an additional penalty of perpetual disqualification from public office, to vote and to participate in any public election.

When, upon trial for violation of this section, the defendant is shown to have had possession of the article in question, possession shall be deemed sufficient evidence to authorize conviction unless the defendant shall explain the possession to the satisfaction of the court: Provided, however, That payment of the tax due after apprehension shall not constitute a valid defense in any prosecution under this section.

5. Customs Valuations

i. First Sale

The first sale doctrine is not used or recognized in the Philippines.

ii. Dutiability of Royalties and License Fees

One of the common methods utilized by the now defunct BOC PEAG (whose functions have been transferred to FIU) to compute deficiency duties and import taxes was to simply obtain the amount of payments of royalties and license fees, and divide it by the applicable withholding tax rate. The results were then put forth as the correct customs valuation of the products (imported and) sold, which were then compared with the declared values of the importations. The importer/taxpayer was then left to justify and demonstrate why the foregoing should not be the case. The importer/taxpayer would mostly cite OECD principles to justify its position.

Nevertheless, while legal arguments were resorted to, BOC PEAG would not necessarily base its findings and resolutions of cases on those principles. While the process described above made it easier to arrive at a mutually acceptable compromise amount to settle the customs duty and import tax assessments, it did not contribute to the development of legal principles that could be relied upon by importers/taxpayers.

6. Enforcement of IP Rights

Trademarks, patents, copyrights and other IP rights may be recorded with BOC.

BOC's Intellectual Property Rights Division (IPRD) has been very proactive in reporting possible counterfeit products imported to the Philippines to IP owners. However, a majority of counterfeit products imported to the Philippines are not identified for, among others, the following major reasons:

i. the BOC IPRD's lack of personnel to monitor all of the ports in the Philippines for the entry of counterfeit goods;

ii. lack of sufficient equipment to inspect all the shipments; and
iii. lack of formal training of relevant customs personnel to identify counterfeit products.

Brand owners are always encouraged to record (or update the recordals of) their IP rights with BOC and conduct training, so that BOC is apprised in distinguishing original and counterfeit products. The brand owner is also urged to provide information on how its products are shipped into the Philippines: i.e., where its products originate from, who the authorized shipper or importer is, and who the authorized consignee is. In this way, the BOC IPRD will be more efficient in narrowing possible counterfeit shipments, based on certain irregularities in the information provided by brand owners, instead of depending on the actual inspection of shipments into the Philippines.

7. Country-of-origin Marking

Generally, every article of foreign origin imported into the Philippines must be marked in any official language of the Philippines, and in a conspicuous place, as legibly, indelibly and permanently as the nature of the article will permit, in such manner as to indicate to an ultimate purchaser in the Philippines the name of the country of origin of the article. There are, however, exceptions to the general requirement. In the case of those exceptions, the immediate container must be marked accordingly.

China

China is among the largest markets in the world for luxury and fashion goods. Although China has articulated a desire to develop its consumer market, relatively high tariff and turnover tax rates on luxury and fashion goods continue to prevail. These duties and taxes have affected growth in China's luxury and fashion industry, to the benefit of neighboring jurisdictions such as Hong Kong, which imposes no duties or taxes. In addition, wearing apparel, jewelry, cosmetics, and similar luxury and fashion goods, face an aggressive enforcement environment, which is both revenue-based, as with customs' challenges to the valuation of imported luxury and fashion goods, and non-tariff based, as with China's unique product quality regulations that are actively enforced at the border. Compounding the difficulties that these enforcement priorities present are foreign currency regulations that effectively limit or eliminate certain transfer pricing and customs valuation options that may be available in other jurisdictions. As a result of these areas of concern, China remains a complex and challenging customs jurisdiction.

The General Administration of Customs of the People's Republic of China (GAC or Customs) is the authority that oversees the import and export of goods into China, and collects duties, taxes and fees, and enforces the laws and regulations at the border crossing. Unlike other government agencies in China, GAC is not divided along regional or provincial lines. Rather, GAC, which is directly subordinate to the State Council (the highest administrative body within the People's Republic of China (PRC) government), directly overseas customs offices across China.

In addition to customs, the State Administration of Quality, Supervision, Inspection, and Quarantine (AQSIQ) administers China's product safety and quality laws, including labeling compliance, through its 35 local port China Inspection and Quarantine (CIQ) bureaus. The compulsory commodity inspection, inward and outward, is discussed more fully below.

1. Customs Valuation

Overview of Rules: The Tariff Schedule of PRC (China Tariff Schedule) provides for relatively high duty rates for luxury and fashion goods. For example, the ordinary duty rates for imported apparels, cosmetics and jewelry are roughly 14–20 percent, 6.5–15 percent and 20–35 percent, respectively. All imported goods in China are subject to a 17 percent import VAT, which applies to the duty-paid price of the goods. In addition, certain specific categories of goods, including cosmetics and precious jewelry, are subject to consumption taxes ranging from 5 to 30 percent upon importation (please refer to section (e) for detailed discussions of the VAT and consumption tax). Therefore, customs valuation is a major issue in assessing the duty and tax liabilities for imported luxury and fashion goods.

Customs valuation in China is governed by Customs Measures for the Determination of Dutiable Value of Imports and Exports, Order [2013] No 213 (Order 213), issued by GAC, which is in conformity with the Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994 (WTO Valuation Agreement). Order 213 provides for the following valuation methods, which should be applied in a hierarchical order:

i. transaction value;
ii. transaction value of identical goods;
iii. transaction value of similar goods;
iv. deductive value (in-China resale price minus profits and in-China expenses);
v. computed value (cost of production, overhead expenses and profits); and
vi. reasonable ("fall back") method determined by customs.

Transaction value is the preferred method of valuation. All other valuation methods would be applied only if transaction value is deemed unacceptable.

With respect to the distribution of luxury and fashion products in China, the commonly adopted business model is that the overseas brand owner serves as the regional principal for the distribution operations. The principal acquires title to the goods from the contract manufacturers, which are located in either China or other Asian Pacific countries, and reinvoices them to an affiliated Chinese distributor. If the goods are produced by a Chinese contract manufacturer, they would need to be "round-tripped" via a free trade zone (FTZ), in order to transfer the title to the overseas principal and be reimported into the customs territory of China by the related Chinese distributor. The primary purpose of the "round trip" is to ensure compliance with China's foreign exchange regulations, while minimizing the potential VAT liabilities arising from the title transfers. As such, regardless of whether the goods are consigned directly from an Asian Pacific country to China, or locally produced in China and "round-tripped" via a FTZ, the importation of the goods into the customs territory of China would occur between the overseas principal and its affiliated Chinese distributor. This structure would give rise to questions as to whether the imported goods sold by a related party are appropriately valued in an arm's length transaction, such that the price between the related parties is acceptable for customs valuation.

China Customs would also examine the transactions in order to determine whether any additions to the transaction value are required. In relation to the aforementioned transaction structure, the additions most likely to be considered by China Customs are royalties and license fees.

Related Party Transactions: Order 213 provides that transaction values agreed upon by related parties would only be acceptable if the relationship between the parties has not influenced the transaction values. It further provides for two means of establishing absence of influence: (1) an examination of the circumstances surrounding the sale and its conformity with ordinary business practices in the industry; and (2) a test of whether the transaction value closely approximates the test values calculated based on the alternative valuation methods.

In practice, China Customs and its local agencies often hold inconsistent views on what constitutes "circumstances" that conform with the arm's length business practices, especially when the related parties belong to a multinational group that has internal transfer pricing policies. Some local Customs houses take the position that transfer pricing policy *per se* is an indication of *de facto* price manipulation, which should render the transaction values unacceptable. Other Customs houses are more amenable to accepting the portions of the transfer pricing studies that are relevant to establishing an arm's length benchmark, and may be used for further analyses from a customs valuation perspective. For example, the benchmark analysis under the Transactional Net Margin Method (TNMM) usually provides an interquartile range of the arm's length operating margins of comparable companies, which might sometimes be used by Customs as a benchmark for determining whether the import price paid by the Chinese importer has enabled it to derive an unreasonably high net profit. Regardless of the attitudes toward the "circumstance of sale" method, under many circumstances, local Customs houses would simply compare the import prices against Customs' internal reference price databases in order to determine the acceptability of the transfer pricing methods. Because this internal database is not publicly available, this adds unpredictability to the customs valuation for related party transactions.

Customs would also accept the "test value" methods if the "test values" derived by the alternative valuation methods closely approximate the transfer prices agreed upon by the related parties. Nevertheless, Customs has considerable discretion in determining whether the profits and overhead expenses used to derive the deductive or computed values are "reasonable" and, thus, whether the resultant "test values" are acceptable. In this regard, Customs may again use the internal reference price database in establishing the reasonableness of such profits and expenses.

As is the case with many other countries, there is a tension between the transfer pricing regime, which basically requires that transactions between the related parties be sufficiently profitable, and the customs valuation regulation, which requires that related parties do not keep the transaction prices artificially low. While the tax authority would only review the profitability at the entity level in an transfer pricing audit, Customs requires a review on a transaction-specific basis. As a practical matter, because the customs authorities themselves often find this tension irreconcilable, many valuation disputes may ultimately be settled on the basis that the importer agrees to make upward adjustments to their import prices. Such adjustments may be either retrospective or prospective, such that greater liabilities may be avoided.

Dutiability of Royalties: Order 213 provides that royalties and license fees paid by the Chinese importer must be added to the price actually paid or payable for the imported goods in determining the customs value, if (1) they are related to the imported goods; and (2) paid by the buyer, directly or indirectly, as a condition of sale of the goods, to the extent such royalties and fees are not included in the price actually paid or payable.

In relation to the distribution of luxury and fashion goods in China, the Chinese importers usually pay the overseas sellers for various types of licensed rights, which primarily include the trademark and the right to distribute. Generally speaking, the trademark and the right to distribute the imported goods within China are related to the imported goods for the purposes of Order 213. Therefore, the determining factor of whether the royalties or license fees are dutiable is the "condition of sale" element of the two-prong test. In this regard, the criteria for "condition of sale" provided for by Order 213 are (1) whether the buyer can purchase the imported goods without paying the royalties or license fees; and (2) whether the imported goods can be delivered based on the agreed terms of sale without paying the royalties and license fees.

Therefore, the best practice for establishing the non-dutiable royalties or license fees is to decouple the requirement to pay these royalties from the sale of the imported goods, such that the buyer has the ability to purchase the imported goods before paying royalties. In practice, such "decoupling" must be supported by robust evidence, including the agreements between the buyer and seller, and evidence showing that such agreements have been actually implemented.

2. Foreign Exchange Controls

Cross-border foreign exchange transactions in China are principally governed by the Regulations of the People's Republic of China for the Control of Foreign Exchange (Forex Regulations), promulgated by the State Council and effective from 5 August 2008. The Forex Regulations provide that foreign exchange remittances under the current account (as opposed to "capital account") must be pursuant to legitimate transactions. Financial institutions should verify the transaction documents, in order to ensure consistency between the remittances and the underlying transactions.

SAFE supervision: With respect to foreign exchange transactions in connection with import and export of goods, the State Administration of Foreign Exchange (SAFE), which is China's foreign exchange regulatory authority, issued the Guidelines on Foreign Exchange Administration for Trade in Goods (Forex Guidelines), and the Implementation Regulations for the Guidelines on Foreign Exchange Administration for Trade in Goods (Implementation Regulations for Forex Guidelines), both effective from 1 August 2012. According to these guidelines and implementation regulations, SAFE uses the following mechanism to supervise compliance with the foreign exchange control:

- SAFE maintains a web-based system to gather foreign exchange and import and export data for each company involved in cross-border foreign exchange transactions.
- SAFE will compare the import or export data against the outward or inward remittances of foreign exchange for each particular company. This exercise relies upon the aggregated (e. g., annual aggregate) trade and payment data of the company, and may be done either periodically or randomly.
- Where SAFE identifies a significant discrepancy between the import data and the outward remittance, or between the export data and the inward remittance, it may conduct an on-site audit of the company. According to article 46 of the Implementation Regulations for Forex Guidelines, the discrepancies that may trigger such an audit include:

- the outstanding payables, on an annual basis, account for more than 25 percent of the total import value; or
- the outstanding receivables, on an annual basis, account for more than 25 percent of the total export value.

Because SAFE examines a company's imports and exports separately, to the extent a company is engaged in both categories of transactions, it must make both inward and outward remittances pursuant to the import and export transactions. The company would not satisfy the examination requirements if it offsets the payables and receivables, and only collects (or pays) a net amount.

The Implementation Regulations for Forex Guidelines also make provision for a company's obligation to report outstanding receivables and payables. Specifically, deferred collections or payments with a term of more than 90 days, and advance collections or payments with a term of more than 30 days, should be reported to SAFE. For "downgraded' companies (discussed further below), the threshold period for reporting would be shorter.

Operation procedures for inward and outward remittances: While SAFE adopts a macro approach to supervise the compliance of individual companies, it delegates the authority to approve specific foreign exchange transactions to qualified foreign exchange banks. Specifically,

- For exports, the exporter may freely receive the foreign exchange payments into one of its foreign exchange accounts designated by SAFE. It is only required to complete some foreign exchange formalities with the bank in order to transfer this fund out of the designated foreign exchange account. The company may also receive the foreign exchange payment directly into an offshore account, provided that the offshore account is registered with SAFE, such that the transactions in that offshore account are also under SAFE's supervision.
- For imports, the importer may apply directly to a foreign exchange bank to collect the foreign exchange payments based upon any of the following transaction documents: (1) commercial invoice; (2) customs declaration form; or (3) supply agreement.

Where a company engages an import/export agent (I/E agent) to act as the importer or exporter of record, with the company itself being the consignee or consignor, the Forex Guidelines provide that the I/E agent directly handle the foreign exchange remittances, and the monies may be transferred between the agent and its principal, based upon the agency service agreement.

For companies with a bad track record of compliance, or where there is a significant "imbalance" between the foreign exchange remittances and import/export transactions, SAFE may downgrade the companies to class B or C (the default rating for all companies is class A), such that they are subject to heightened supervision. The extra supervisory measures may include approval of remittances on a transaction-specific basis, and the requirement to provide additional documents to support the underlying transactions.

Penalties for non-compliance: The foreign exchange regulations do not directly impose penalties on a company for a failure to collect or remit foreign exchange payments for an import or export transaction, or a failure to report overdue receivables or payables. Nevertheless, as discussed above, if such failure results in a significant "imbalance" between the foreign exchange remittances and import/export transactions, SAFE may conduct an audit, and downgrade the company so as to heighten the supervision measures. In addition, falsifying transaction information in order to collect or remit foreign exchange payments may subject the company to a fine of up to RMB300,000.

3. Labeling and Other Product Regulatory Issues

Labeling: Under Chinese law, a label must be affixed to all imported products, which specifies information with respect to (1) product description; (2) name of producer or distributor; (3) passage of the manufacturer's internal quality inspection; (4) useful life; and (5) instruction for use. All information must be in standard Chinese. With respect to specific categories of products, the regulations and the relevant National Standards published by AQSIQ, or its affiliated agencies, provide for additional compulsory and optional items in a product label. For example:

- for cosmetics, the regulations and the National Standards have detailed requirements for identifying the ingredients; and
- for jewelry, there are regulations and standards related specifically to the accuracy of the weight on the label and the tolerance for discrepancies between labeled and actual weight.

The CIQ agencies established by AQSIQ at the various gateway ports are responsible for inspecting the labels of certain specified products, including cosmetics and apparels, upon arrival at the port. In addition, cosmetics used to be one of the product categories that required pre-shipment label review. Following the issuance of Circular [2006] No 44 by AQSIQ on 24 March 2006, the pre-shipment label review is no longer a mandatory requirement for imported cosmetic products. Nevertheless, CIQ continues to conduct heightened examinations of the labels of cosmetics upon arrival, such that non-compliant labels may cause serious delay in import clearance. Therefore, as a practical matter, many importers continue to have cosmetic labels reviewed by the CIQ office at the gateway port, prior to importing them into China.

Whether or not the product label has been examined by the gateway port upon arrival, when luxury and fashion products are entered into the Chinese market for sale, the labeling of these products is subject to oversight by the domestic regulatory agencies, which principally include the Quality and Technology Inspection Bureau (QTSB) and the Administration of Industry and Commerce (AIC). While both agencies enforce the same labeling regulations and National Standards in the domestic market, the implementation by the agencies and their city or district level counterparts may vary with locality. Retailers of luxury and fashion goods, especially the foreign-owned retailing entities, usually maintain their own standard operational procedures, or reaction plans in response to random inspections by these regulatory agencies. These are helpful in avoiding missteps in dealing with the authorities.

Inward and outward commodity inspection: China maintains a catalogue of products (by tariff codes) subject to compulsory inspections upon import into (i.e., inward) or export out of (i.e., outward) China. Products included in the catalogue must be declared to CIQ at the gateway port upon arrival, and CIQ will pick up samples from the cargo for laboratory testing based on the applicable national standards with respect to quality and safety. The goods cannot be released for use or sale in China, or depart from a China port, until the sample tests show that the products comply with the national standards.

China periodically amends its compulsory inspection catalogue. Based on the most recent catalogue, most cosmetic products are subject to both inward and outward compulsory inspections. Apparel products are generally no longer subject to outward compulsory inspection, following a notice issued by AQSIQ on 1 August 2013. Nevertheless, a significant portion of apparel products are still subject to inward compulsory inspection.

The compulsory commodity inspection regime imposes considerable compliance burdens on Chinese importers and exporters of cosmetic and apparel products, and prolongs the lead time for customs clearance.

For goods that are imported from abroad into a FTZ, or that originate in the non-bonded customs territory of China and are reimported into the customs territory of China through a "round-trip" via a FTZ, CIQ would usually waive the physical inspection (including the laboratory testing). This would facilitate utilization of FTZs as RDCs. Other than these exceptions, inbound and outbound movements of goods between a FTZ and the customs territory of China are subject to the same requirements for compulsory inspection as ordinary imports and exports.

Special approvals for imported cosmetics: Cosmetics are subject to heightened regulatory requirements in China. The regulatory regime classifies all cosmetics into "specified" and "non-specified" cosmetics. The specified cosmetics include products intended for a particular function or benefit, such as hair growing, hair dying, breast beautification, freckle eliminating, etc.

The foreign manufacturer of the imported cosmetics must obtain an administrative license from China Food and Drug Administration (CFDA) for each type of cosmetics imported into China, including specified and non-specified cosmetics. If the cosmetics are produced in China (including cosmetics that are imported in bulk into China and subsequently rebottled or repacked in China), the Chinese manufacturer must obtain an administrative license for production of specified cosmetics, and file a recordal for production of unspecified cosmetics.

Application for an administrative license requires the applicant to provide extensive information with respect to product safety control, hygiene analysis and the relevant scientific literature, as well as a laboratory testing report issued by a government-designated institute. Sample products should also be provided for inspection. The recordal for unspecified domestic cosmetics generally requires the applicant to prepare the same information. However, instead of submitting the information directly to the authority, the applicant only needs to make the information available for examination.

Foreign manufacturers of imported cosmetics must appoint a "responsible party", which must be a legal entity incorporated in China, to file the application for an administrative license. This responsible party would be held liable for inaccuracy of the submitted information and the quality claims arising therefrom.

4. Cross-border E-commerce

Overview of rules: China allows a foreign seller to directly sell consumer goods to a Chinese customer under the business to consumer (B2C) model. The traditional way of exporting such goods into China is that, after the Chinese consumer places a purchase order over the seller's e-commerce website, a courier or postal service provider picks up the product from a delivery point in the exporting country, and dispatches it directly to the consumer in China. For China customs clearance purposes, to the extent the consumer goods meet certain criteria (discussed further below), they may be classified as "personal articles", rather than ordinary consumer goods. As a result, the consumer will be identified as the consignee, which is responsible for the customs clearance, with the assistance of the courier or service providers. The goods are subject to a special tax rate for personal articles, which combines customs duty, VAT and consumption tax. This special tax rate is substantially lower than the aggregate of the three taxes that would otherwise apply to ordinary commercial goods.

The conditions for classifying a consignment of goods as a "personal article" include (1) the value of the goods does not exceed RMB1000; or (2) if the consignment contains only one inseparable piece of product that is obviously for personal consumption, the value of this single product may exceed RMB1000. Failure to meet these conditions may result in rejection of the import, because, under Chinese law, only corporations can act as importers of record to import ordinary commercial goods.

While the traditional B2C model remains valid, China launched in early 2014 a pilot program for cross-border e-commerce in six pilot cities, including major coastal and inland ports, such as Shanghai, Guangzhou and Chongqing. Under this pilot program, each pilot city has designated certain qualified e-commerce platforms (i.e., e-commerce websites) and e-commerce service providers (including online store operators, logistics companies and payment service providers,). A foreign seller may engage the qualified service providers to sell its products on the designated e-commerce platforms, and have the products directly consigned to the Chinese consumers. Although the same criteria for "personal articles" still apply to these products for customs clearance purposes, the processes may be conducted on an expedited basis. In addition, the foreign seller may set up inventory in a FTZ designated by the pilot cities, and pick and dispatch the goods to customers in the customs territory of China. The goods dispatched by the foreign seller from the FTZ to its customers in the customs territory of China are entitled to the same treatment as cross-border e-commerce goods.

Due to the substantial price difference between the luxury and fashion goods sold in Chinese and foreign markets, e-commerce shopping has become increasingly popular. In the traditional B2C model, customs only oversees the import clearance of the products, while lacking leverage over the foreign sellers and the platforms they use to sell the products. Smuggling of products under the traditional delivery model is also a big concern of customs. Therefore, on the one hand, China Customs is cracking down on smuggling in the traditional consignments of "personal articles" but, on the other hand, it offers facilitation measures (e.g., expedited customs clearance, FTZ storage that could reduce the fulfillment cycle, etc.) in order to promote the new cross-border e-commerce program. In the long run, the advantages of the new e-commerce mode may become more obvious.

<u>Product regulatory concerns in e-commerce mode</u>: Under the existing law, consumer goods consigned directly from abroad to end consumers are generally exempted from the product regulatory requirements (e.g., labeling, commodity inspection) that would otherwise apply to ordinary commercial goods. Nevertheless, as the cross-border e-commerce model becomes increasingly popular, the regulatory authorities, including AQSIQ and CFDA, are contemplating regulations to regulate certain "sensitive" consumer goods sold directly into China via e-commerce. As a result, it is likely that at least some of these consumer goods would no longer be completely exempted from China's labeling and product regulatory requirements.

5. Turnover Tax Considerations

Overview of Rules: The import of luxury and fashion products into China is subject to a 17 percent VAT, in addition to customs duty. This import VAT is creditable against the output VAT incurred on domestic sale of the goods in China. If the goods are locally manufactured in China and exported to an overseas principal, the VAT previously incurred on purchase of the domestic materials (usually 17 percent) would be refundable upon export of the finished goods out of China. The amount of refundable VAT depends on the export VAT refund rate (EVRR) provided for by China Tariff Schedule.

Example 1: The apparel products are imported at \$100 and sold to a Chinese distributor at \$150. Then:

- the import VAT is 17% of \$100 = \$17;
- the output VAT is 17% of \$150 = \$25.5; and
- because the import VAT is fully creditable against the output VAT, and the output VAT can be "reverse-charged" to the distributor and ultimately passed along to the end consumer, the net tax exposure for the Chinese importer is 0.

Example 2: The contract manufacturer purchases raw materials from local suppliers for \$100, and processes the raw materials into apparels that are exported to the overseas principal for \$200. The EVRR for apparel products is 16 percent. Then:

- the input VAT on purchase of raw materials is 17% of \$100 = \$17;
- the amount of VAT refundable is 16% of \$200 = \$32;
- notwithstanding the fact that the total VAT refundable is \$32, to the extent the contract manufacturer does not have any other excess input VAT, it cannot claim a VAT refund for more than \$17;
- in addition, because the EVRR is lower than the VAT for the domestically purchased raw materials, a portion of the VAT previously incurred by the contract manufacturer is unrecoverable. The amount of unrecoverable VAT is 17% of \$200 - 16% of \$200) = \$2; and
- as a result, the total amount of VAT refund the contract manufacturer can claim is \$17 - \$2 = \$15.

The EVRRs for ordinary apparel, cosmetic and jewelry products are roughly 16 percent, 13 percent and 0 percent, respectively.

The manufacturers and importers of certain categories of products are responsible for consumption taxes. The manufacturers must pay the consumption tax upon sale of the taxable goods to customers, and the importer must pay the consumption tax at the time of import. Consumption tax is not recoverable through credit or refund (unless the finished products and the raw materials used to manufacture the finished products are both taxable goods, in which case the manufacturer may claim a deduction allowance). As a result, it simply becomes a cost for the manufacturer or importer, and is ultimately passed along to the end consumers.

The consumption tax rates for major luxury and fashion products are as follows:

- cosmetics – 30 percent;
- jewelry of precious metal and/or diamond – 5 percent; and
- other jewelry – 10 percent.

VAT deferral: Under Chinese law, when a wholesaler sells the merchandise to a retailer, a 17 percent VAT is due at the time of sale. However, when the wholesaler simply consigns the merchandise to the retailer for ultimate retail sale to end consumers at the retailer's premises, the VAT is payable upon ultimate retail sale to the consumer. This model would enable a deferral of VAT for the internal allocation of merchandise until the retail sale occurs, and minimize cash flow for the retailer. For merchandise not sold by the retailer, the goods can be returned within 180 days without incurring any VAT, or the VAT position can be reversed with a red-letter VAT invoice.

6. Regional Distribution Centers and Related Issues

Overview of rules: Regional distribution centers (RDCs) are essential in supporting large-scale retail and direct-to-consumer operations. China maintains special bonded areas (FTZs) in more than 15 cities. These include export processing zones (EPZs), bonded logistic parks (BLPs), and integrated bonded zones (IBZs), mostly located in cities with a geographic advantage for trade. They are outside the ordinary customs territory of China for regulatory purposes. Therefore, the otherwise dutiable goods may be imported from abroad into these FTZs without incurring any customs duty or VAT. They would only become subject to customs duty and import VAT when sold into the customs territory of China. On the other hand, sale of goods from the customs territory of China into these FTZs is deemed export, such that the seller may be entitled to an export VAT refund that is otherwise available to those who directly export to a foreign country.

In addition to these traditional FTZs, the central government of China launched a pilot FTZ, namely the China (Shanghai) Pilot Free Trade Zone (SPFTZ), on 29 September 2013, for the purposes of advancing China's reform on a trial basis. Other than the traditional logistics functions, SPFTZ has put in place certain trade facilitation measures, which are unavailable elsewhere in China. These principally include:

i. simplified customs clearance and inward commodity inspection procedures for goods entered from abroad into SPFTZ;
ii. filing of customs declarations and payment of customs duties and import VAT on a periodical, rather than a transaction-specific, basis, for goods imported from SPFTZ into the customs territory of China; and
iii. reduced formalities for bonded warehouse supervision.

Given the geographic advantages of these FTZs and the strategic importance of the Chinese consumer market, choosing one of these FTZs as a RDC may minimize the fulfillment cycle. The duty and VAT deferral benefits would also maximize the duty and tax efficiencies for the distribution operations.

Hong Kong is an independent customs territory and a separate jurisdiction from mainland China. Hong Kong does not have turnover taxes, and, except for very limited categories of products, does not collect customs duty for imported goods. Therefore, Hong Kong may also be preferred as a RDC.

Eligibility to operate in a FTZ: A company must be established in the FTZ in order to operate in the FTZ. One of the conditions for establishment is that the company owns or leases a physical space in the FTZ (normally an office space no less than 30 square meters for trading or logistics companies). Given the limited space in most of the FTZs, this condition is often difficult to fulfill.

Companies not established in the FTZ would need to engage a third-party logistics service provider (3PL) to conduct customs clearance formalities, and handle warehousing and logistics operations.

FTA qualifications: China has a FTA with ASEAN – namely, the ASEAN-China Free Trade Area (ACFTA) – which provides for tariff concessions for trade between China and the ASEAN members. To the extent ASEAN members, such as Vietnam and the Philippines, are also major producers of luxury and fashion goods destined for the Chinese market, qualification for a FTA is an important consideration in choosing a location for a RDC.

The Rules of Origin of ACFTA and the implementation rules issued by GAC provide for a "direct consignment" rule. Under this rule, if the goods consigned from an ASEAN member are transported through a non-ASEAN member where the products have undergone operations other than loading and reloading, or any operation required to keep them in good condition, the ACFTA duty rates should not apply.

China enforces this rule in a more stringent manner. If the goods physically pass through a third country, GAC requires a through bill of lading to evidence the "direct shipment". This requirement may only be waived when there is additional evidence to support the undisrupted flow of goods between the origin and destination, and usually requires *ad hoc* approval by GAC.[79] Therefore, if Hong Kong were used as a RDC where the goods are picked, packed, dispatched and relabeled before consigned to the ultimate destination in mainland China, such activities would be deemed beyond operations merely required to keep goods in good condition. As a result, GAC would deny the application of the ACFTA duty rate to the goods upon arrival at a mainland China port.

On the other hand, if the RDC is located in a FTZ, although it is technically outside the customs territory of China, GAC allows the goods to be picked and packed in the FTZ and dispatched into the customs territory of China in separate consignments without affecting the qualification for FTA duty rates.[80]

PE concerns: When establishing a RDC in a FTZ of China, care should also be taken in order to avoid creating a taxable permanent establishment (PE) in China. Generally speaking, the risk of creating a PE is relatively low if (1) the foreign seller of the goods does not dispatch its own employees to China, or does so for the sole purpose of discharging the seller's obligations under the supply agreement; (2) the agent engaged by the foreign seller, if any, is fully compensated for the services rendered to the seller, and is not authorized to enter into any agreement on behalf of the seller; and (3) the premises where the foreign seller's employees perform the relevant activities are "preparatory and auxiliary" to the main business activities performed by the foreign seller.

All this being said, the PE analysis may involve complicated issues, depending on the facts of individual cases. If the foreign seller is ultimately found to have created a PE, China generally adopts a "deemed profit" method in taxation of the PE where a non-resident enterprise cannot accurately account for the profit and expenses of the PE. However, China does not have detailed profit attribution rules.

[79] Circular Shui Guan Han [2012] No 123, issued by the Duty Collection Department of GAC on 16 August 2012.
[80] Circular [2013] No 36, issued by GAC on 8 July 2013.

Japan

1. Overview

Importers are required to file an import declaration with Japan Customs to report certain information related to the imported goods, including:

- product name;
- quantity;
- cost including insurance and freight (CIF);
- tariff rate;
- liability for customs duty; and
- import consumption tax.

After customs duty and import consumption tax have been paid, an import permit will be issued.

2. Legal Regime

a. Civil Penalties for Customs Violation

Penalties

	Rate on the Custom Duty Due
Filing a Late Declaration	
Penalty for Late Filing	15% (20% on the amount exceeding JPY500,000) (5% if taxpayer files a late tax return not under threat of a tax audit)
Penalty for Fraud (if any)	40%
Filing an Amended Declaration	
Penalty for Under-assessment	10% (15% on the amount exceeding JPY500,000) (0% if taxpayer files a late tax return not under threat of a tax audit)
Penalty for Fraud (if any)	35%

Delinquency Tax

	Lower Rate	***Higher Rate***
2002 to 2006	4.1%	14.6%
2007	4.4%	14.6%

	Lower Rate	*Higher Rate*
2008	4.7%	14.6%
2009	4.5%	14.6%
2010 to 2013	4.3%	14.6%
2014	2.9%	9.2%

Delinquency tax is economically equivalent to an interest charge on late payments of customs duty. The higher rate applies for the overdue period from two months after the statutory due date (in the case of non-payment of customs duty) or within three months of receiving a notice of deficiency. Otherwise, the lower rate applies.

b. Criminal Penalties for Customs Violations

Criminal penalties vary depending on the violation. For example, a person who imports goods that violate IP rights – such as trademark and design rights – may be subject to imprisonment of up to 10 years or a fine of up to JPY10 million.

	Criminal Penalties
Customs Duty Evasion	• Imprisonment of up to 10 years; or • fine of up to JPY10,000,000 (up to 10 times the amount evaded).
Import of Non-permitted Goods	• Imprisonment of up to 10 years; or • fine of up to JPY10,000,000

Statute of Limitations

	Limitation Period
Late Filing and Under-assessment	5 years (7 years in case of fraud)
Import of Non-permitted Goods	7 years

c. Enforcement Climate – Penalties and Detection

Civil Penalties

Failures to report customs duty, including under-assessment and inadequate tariff rates, are detected mainly by customs audits. In the 2013 administrative year (from July 2013 to June 2014), audits were conducted on 3,614 importers. It was found that JPY888 billion was not reported, by 67.2 percent, or 2,427 of 3,614, audited importers. An additional JPY84 million in customs duty and import Japanese consumption tax was levied in this audit period, including JPY593 million in penalties imposed.

Of particular relevance to the luxury and fashion goods industry, the importation of shoes ranks third among underpaid customs duty and consumption tax categories, while clothing ranks fifth.

Criminal Penalties

In 2013, 28,000 importations were suspended for suspected violation of IP rights. In 16 of those cases, importers were charged with importation of goods in violation of IP rights, and in 43 cases, importers paid fines but were not prosecuted.

3. Voluntary Disclosures

Voluntary disclosure of underpaid or under-declared customs duty and consumption tax is permitted in Japan. In the case of late filing or amendment of a customs declaration, if a taxpayer has voluntarily disclosed, absent the threat of a custom tax audit, the penalty will be reduced.

4. Customs Audits

Custom auditors routinely visit importers' offices to conduct customs audits, generally conducting thorough checks of contracts, invoices, financial records and other trade-related documents in relation to imported goods. They may conduct further investigations with an importer's business partners. As a general rule, customs audits are conducted approximately every three years. If customs auditors find faults or deficiencies in an importer's import declaration, the usual procedure is to instruct the importer to file an amended import declaration and pay additional customs duty and (or) import consumption tax.

5. Customs Valuation

a. First Sale

The "first sale" valuation method is not available in Japan.

b. The Use of Transfer Pricing as Customs Value

Tax Documentation

The customs value is generally the amount that actually has been or will be paid by the buyer. If there is a feature of the import transaction that would make accurate determination of the transaction value difficult, one of the following three calculation methods should be employed:

i. the customs value is the transaction value of the identical or similar goods;
ii. where (i) is not feasible, the customs value is calculated based on the proposed sale price in Japan of the goods, or of identical or similar goods; and
iii. where neither (i) nor (ii) is feasible, the customs value is calculated based on the cost of the goods.

Tax documentation for transfer pricing purposes is generally not sufficient to support a customs value calculation, given the competing objectives of the importer and Japan's customs authorities. That is, while the importer seeks to minimize the value of imported goods to the acceptable arm's length price needed to satisfy the Japanese tax authorities for income tax purposes, Japan Customs will seek to maximize values for customs duty purposes. There is currently no rule or regulation to coordinate transfer pricing and customs valuations. Nonetheless, transfer pricing documentation may include useful information for the purposes of a customs valuation.

Retroactive Adjustment

Price adjustments may be made between related parties after a certain period of time, in order to adjust the transfer price to the actual arm's length price that is calculated taking into consideration the financial situation during that period. These are referred to as 'retroactive adjustments'. The importer should report a retroactive adjustment by filing an amended import declaration, as the Customs Tariff Act provides that the customs value is the price that has been or will be paid by the buyer to the seller. If the adjustment is not reported, the likelihood of it being uncovered during a customs audit would be high, with penalties due in addition to underpaid customs duty, import consumption tax and delinquency tax.

c. Coordination Between Customs Authorities and Tax Authorities

There is no official coordination and information-sharing system between Japan's customs authorities and tax authorities. They do, however, occasionally meet and share audit experiences and provide information to each other. Given that import consumption tax is currently collected by customs authorities, the existing infrastructure and systems in place suggest that further and closer mutual cooperation is a realistic possibility.

d. Royalties and License Fees

Article 4(1)(iv) of the Custom Tariff Act provides that customs value should include royalties for patents, design rights, trademark rights and the like (but excluding the right to copy the imported goods in Japan) associated with the imported goods directly or indirectly paid by the buyer *in order to* import such goods. The Cabinet Enforcement Order for article 1-5(5) of the Customs Tariff Act further provides that royalties and license fees for utility model rights, copyright and copyright-related rights, production processes using special techniques, etc., should be included in the customs value. The following examples illustrate this.

Example 1
Japan 1 Co imports shoes with a trademark from China Co. China Co is a manufacturer of shoes and has a manufacturing license from Japan 2 Co. Japan 2 Co is the holder of the trademark rights. Japan 1 Co pays a royalty for the trademark to Japan 2 Co, as well as paying the proceeds for the shoes to China Co. Japan Co cannot import the shoes from China Co without paying a royalty to Japan 2 Co.
In this case, the royalty is paid for the trademark attached to the imported goods; thus, it is regarded as being paid in association with imported goods. Also, the buyer (Japan 1 Co) cannot import the goods from the seller (China Co) without paying the royalty; thus, it is regarded as being paid by the buyer in order to import the goods. Therefore, the royalty should be included in the customs value.

Example 2
Japan Co imports concentrated liquid soft drink from US 1 Co. Japan Co mixes the concentrated liquid with water, sugar and soda, pours it into a bottle with a trademark in Japan, and sells the bottled soft drink in Japan. Japan Co pays a royalty for the trademark to US 2 Co, who is the holder of the trademark right. Japan Co cannot buy the concentrated liquid from any manufacturer other than US 1 Co,, as required by US 2 Co.
In this case, the imported concentrated liquid is transformed by being mixed with other ingredients in Japan; thus, it is essentially different from the finished product, to which the trademark is attached. Thus, the royalty is not associated with the imported goods, so does not need to be included in the dutiable price.

6. IP Rights

a. Process for Recording Trademarks with the Customs Authorities

IP rights, such as trademarks, are not registered with Japan's customs authorities. Rather, trademarks and related rights are registered with the Legal Affairs Bureau.

b. Enforcement Climate with regard to Counterfeit Goods at the Border

Request for Import Suspension by the Holder of IP Rights

A holder of IP rights, such as trademarks and design rights, can file a request for import suspension with customs, if he or she can prove that counterfeited goods have been or are expected to be imported into Japan.

Identification Procedure by Customs

Once customs finds goods suspected of being counterfeit, it will conduct an identification process to determine whether the goods are genuine or not. The holder of IP rights and the importer are required to express their opinion and submit evidence to Customs. In cases where a request for import suspension has been filed and the importer does not protest, the Director-General of Customs would determine whether the importation includes or comprises counterfeit goods, without requesting the opinion or evidence of the importer and the owner of the IPR.

7. Country-of-origin Labeling

There is no country-of-origin labeling requirement in Japan. However, foreign goods displaying the incorrect country of origin are not permitted to be imported.

Australia

1. Legal Regime

There are a range of civil penalties for customs violations, including for strict liability and absolute liability offenses.

The Criminal Code applies to offenses under the customs legislation in Australia. Examples of criminal offenses under Australia's customs law include the importation of prohibited items.

Under section 249 of the Customs Act 1901, customs prosecutions may be instituted at any time within five years after the cause thereof.

Australian Customs makes extensive use of warning letters and infringement notices. Infringement notices were introduced in recent years, to provide a simpler way of dealing with many strict liability infringements, including under-reporting duty and if a misrepresentation is found in a customs declaration. Warning letters can also be issued, instead of an infringement letter. Infringement notice penalties are fixed at 25 percent of the maximum that a court could impose if the matter were prosecuted.

The practice of Australian Customs is to limit prosecutions to more serious breaches. There is a commonwealth government policy on deciding whether to prosecute. Factors considered include the likelihood of a conviction, whether the breach is trivial and whether it is in the public interest to prosecute.

2. Voluntary Disclosure

Australia's customs legislation allows voluntary disclosure of some offenses, including under-reporting duty and if a misrepresentation is found in a customs declaration. Where this is available, the business can disclose the incorrect reporting, and pay any under-reported duty or correct the misrepresentation in the customs declaration. In this case, the business will not be taken to have committed an offense.

Disclosure must be voluntary. The voluntary disclosure protection ceases to be available if, before the voluntary disclosure is made, customs issues a notice proposing to exercise its monitoring (audit) powers, seeks to exercise powers to verify the information, issues an infringement notice or starts prosecution proceedings.

3. Audit

Australia's customs legislation contains general powers for customs to monitor and audit matters regulated by it. There are a range of additional specific monitor and audit powers for particular areas of enforcement.

A customs officer may enter premises to exercise monitoring powers:

- with the consent of the occupier; or

- under warrant, for the purpose of checking compliance with a customs law (including record-keeping).

Monitoring powers include:

- the power to search premises;
- the power to take photographs (including a video recording), or make sketches, of premises or anything at the premises;
- the power to inspect, examine, count, measure, weigh, gauge, test or analyze, and take samples of, anything in or on the premises;
- the power to inspect any document or record in or on the premises;
- the power to take extracts from, or make copies of, any document or record in or on the premises;
- the power to take into or onto the premises any equipment or material reasonably necessary for the purpose of exercising the above powers;
- the power to test and operate record-keeping, accounting, computing or other operating systems of any kind that are at the premises and may be used to generate or record information or documents of a kind that may be communicated to customs;
- the power to, for a period, secure a thing a monitoring officer finds and believes on reasonable grounds affords evidence of the commission of an offense against a customs-related law and may be lost, destroyed or tampered with;
- powers to operate equipment to check information; and
- powers to copy information found by operating equipment.

Monitoring powers also include the ability to ask questions and seek assistance.

4. Customs Valuation

a. First Sale

The "first sale" principle is not available in Australia.

b. Customs Values

Australia's customs legislation provides a number of different methods for arriving at the customs value. Those methods must be considered in strict order and are broadly consistent with WTO's Valuation Agreement. The methods include: transaction value; identical goods value; similar goods value; deductive (contemporary sales) value; deductive (later sales) value; deductive (derived goods sale) value; computed value; and fall-back value.

c. Transfer Price as Customs Value

Australian Customs will pay close attention to related party transactions, to ensure the appropriate valuation methodology is adopted and the appropriate valuation is declared. The most common valuation method is the "transaction value" method.

The main issue for related party transactions is whether the relationship has influenced the price of the goods. The transaction value may be inappropriate where the relationship has influenced the value. Australian Customs may require the purchaser to establish that the price has not been influenced by the relationship.

Customs valuation broadly aligns with valuation for transfer pricing, as it seeks to value goods in accordance with the arm's length principle. It is common for the related parties to obtain a transfer pricing valuation advice from Australian Customs.

Where a valuation advice has been obtained, the parties may rely on the advice and a range of accepted values. This assists with price adjustments post importation. An applicant in a valuation advice is generally the importer of record. The valuation advice typically takes up to four weeks to obtain. It is often the case that significant supporting documentation is required to be provided to Australian Customs.

Australian Customs has issued a practice statement on valuation methods in the context of transfer pricing arrangements. In this context, transfer pricing refers to an agreement between related companies of multinational enterprises to set the price of goods sold between the entities. These agreements may also allow the prices of imported goods to be adjusted at a later stage after the goods have been imported.

An importer may seek a valuation advice from Australian Customs, requesting an appropriate valuation method in this context, and an adjustment range to take into account fluctuations in the transfer price between related parties.

Having regard to the proposed adjustment range in the application, a valuation advice will determine the range of adjustments to customs value, either upwards or downwards, that meets Australian Custom's valuation requirements. Subsequently, when making an adjustment to the customs value of imported goods, the adjustment to each import declaration line must be within the range advised in the valuation advice.

As noted above, Australian Customs may request documentation to support the customs values and agreement between the parties. For example, Australian Customs may require:

- an overview of the business;
- any relevant documentation the applicant considers would assist Australian Customs in making a decision on a transfer pricing issue: e.g., Australian Taxation Office (ATO) advanced pricing arrangement, ATO tax ruling, ATO risk survey or transfer pricing study. In this regard, Australian Customs may coordinate with ATO;
- the organization structure (including all related parties engaged in transactions potentially relevant to transfer pricing): e.g., an organization chart showing the head office and its domestic subsidiaries, foreign subsidiaries, joint venture partnerships, controlled plants, manufacturing and/or processing, and other significant holdings (of 25 percent or more);
- the supply chain for the imported goods (a description of the transactions that result in the goods being imported into Australia and identification of all parties involved: e.g., order trail, sourcing/manufacturing by overseas related party and exportation of goods); and
- inter-company agreements, policies or guidelines relating to the supply and transfer price of the imported goods: e.g., the distribution agreement, cost contribution agreement, royalty and license agreements, sale and purchase agreement between the exporting company and the importing company in relation to the goods covered by the import declarations in question that allows the price adjustment post importation of the goods.

Retroactive adjustments to the transfer prices (after importation) must be reported to Australian Customs (even if a valuation advice supporting adjustments has been obtained). The appropriate method for making a retroactive adjustment to the transfer price is to obtain an approved range from Australian Customs (through a valuation advice) and then report the adjustment to Australian Customs (paying the additional duty or claiming a refund).

d. The Dutiability of Royalties and License Fees

A royalty and license fee may be treated as a "price related cost" and forms part of the dutiable value of a good for customs duty purposes. The royalty and license fee can be paid to any party, not just the vendor, and still be regarded as part of the customs value. The main issue is determining whether or not the payment is a "royalty". This will require an examination of the circumstances surrounding the transaction and, in particular, the contracts, agreements or arrangements under which the payment described as a royalty is paid.

The meaning of royalty under the customs legislation provides for the inclusion of royalties paid for the forbearance of the doing of certain things by the vendor. For example, royalties that are said to be paid in exchange for exclusive distribution rights are covered by the provision.

There is no universally agreed meaning of the word royalty. It is important to note that even though a payment may be described as a royalty, Australian Customs has noted that many payments may be found to be more properly classified as:

- part of the price for the goods;
- an assist;
- a commission;
- a non-dutiable royalty, such as a payment for the right to reproduce the imported goods; or
- proceeds of subsequent resale, disposal or use.

5. IP Rights

The Australian Trade Marks Act and Copyright Act provide regimes whereby Australian Customs may be empowered to seize, forfeit and destroy imported goods that infringe a registered Australian trademark or copyright.

IP owners must lodge a notice of objection authorizing Australian Customs to seize goods being imported that infringe their registered Australian trademarks or copyright. Once a notice of objection has been recorded, the IP owner (the objector) is notified by Customs if goods infringing their trademarks or copyright are seized.

Where a notice has been lodged, Customs is obliged to seize such goods unless it is satisfied that there are no reasonable grounds for believing that the importation of the goods constitutes an infringement of the relevant trademark or copyright. The following are the key steps in the Australian Customs seizure process:

- Once goods are seized, the objector will be informed, and permitted to inspect or remove multiple samples of the seized goods, in return for the objector providing customs with an undertaking to return or replace the goods if they are found to be genuine;
- customs will be required to give an objector any relevant information that would assist it in identifying the person or entity (whether within or outside Australia) that made arrangements for the goods to be brought to Australia;

- once a notice of seizure is received, the designated owner will have 10 working days to file a claim for return with customs – otherwise, the seized goods will be deemed forfeited and subsequently destroyed;
- if a claim for return is filed, the objector will need to seek an injunction from the court within 10 business days, to prevent the goods from being released to the designated owner; and
- if seized goods are forfeited, they will be destroyed after 90 days.

Customs notices last four years and can be renewed for as long as the relevant right remains in force. Objectors are required to pay no upfront bond in relation to a customs notice. However, they are required to provide a written undertaking that they will reimburse all expenses incurred by customs as a result of a seizure.

6. Country-of-origin marking

A country-of-origin trade description must be applied to certain goods to comply with Australian import regulations. Section 8 of the Commerce (Trade Descriptions) Act 1905 (Cth) states that the regulations will specify which imported goods are required to have a trade description. Goods listed in the Commerce (Imports) Regulations 1940 (Cth) (Import Regulations) as types of goods that are required to have a trade description relevantly includes apparel, shoes, jewelry, a range of goods made of leather (or resembling leather), vulcanite (or resembling vulcanite) or plastic, listed kinds of china, porcelain, earthenware and enameled hollowware, cigars, cigarettes, manufactured tobacco, cigarette papers and cigarette tubes, watches and clocks.

The trade description must:

- be marked on the packages in which the goods are packed (for pre-packed articles);
- contain, in prominent and legible characters:
  - the name of the country in which the goods were made or produced; and
  - a true description of the goods;
- ensure that any matter included on the label, brand or package that is in addition to the matters required by the regulations does not contradict or obscure the matters required to be included; and
- be in English.

Additional trade description requirements apply to shoes.

Importing goods without a required trade description will breach the Import Regulations. Importing goods with a false trade description may result in the goods being forfeited to the crown and/or a penalty. Some defences apply (e.g., where the breach was not intentional).

Applying an incorrect country-of-origin representation could also breach several provisions in the Australian Consumer Law (ACL).[81] For example, an incorrect country-of-origin representation may be:

- misleading conduct in breach of section 18 (there is broad scope to award remedies, including corrective advertising); or
- a false representation under sections 29(1) or 151(1) (in particular, (k), dealing with false origin claims). Penalties apply for breaching these provisions.

[81] The ACL is contained in Schedule 2 of the Competition and Consumer Act 2010 (Cth) (CCA).

Chapter 13: Competition and Anti Trust Issues in the Industry[1]

I. Introduction

Many fashion and luxury goods brand owners consider the ability to control how their products are distributed to be indispensable to the preservation of the image and economic value of their brands.[2] As a result, fashion and other luxury goods brand owners enter into a variety of programs and agreements to better control their brands and distribution. However, these agreements may expose them to a variety of antitrust risks in the United States, both under federal and state law; in Europe, both under European Union (EU) law and under national laws; as well in a number of other major jurisdictions across the globe. The level of risk will generally depend on the jurisdictions in which a lawsuit might be brought, the market share of the parties and the nature of the agreement. However, in most instances, the company's business goals can be accomplished lawfully with careful counseling.

It appears intuitively correct that agreements between competitors (so-called *horizontal agreements*), e.g., to fix prices, should be subject to competition law, given their liability to raise prices for consumers. As such, the application of antitrust/competition law to horizontal agreements, as a matter of principle, is rarely questioned. In contrast, the application of competition law to *vertical agreements*, i.e., agreements between companies operating at different levels of the distribution chain, such as distribution agreements, is not without controversy.

While vertical agreements may have a negative effect on *intra-brand* competition, antitrust/competition law is generally more concerned with the protection of *inter-brand* competition.[3] As a result, a number of jurisdictions take a lenient approach to vertical agreements.[4] Moreover, as regards distribution agreements in particular, many jurisdictions accept that suppliers are best placed to decide how to distribute their products, or only take any real interest in any restrictions contained in distribution agreements where these are entered into by dominant companies.

This chapter contains an overview of the competition law regimes in a number of key jurisdictions across the globe,[5] with a focus on how the relevant regimes apply to distribution agreements. Key enforcement trends in those jurisdictions – in particular as regards distribution agreements and the fashion and luxury goods sector – are highlighted.

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[1] Kurt Haegeman and Sophia Real of the Brussels office are the principal authors and editors of this chapter. The country-specific sections of this chapter were prepared by Georgina Foster and Rowan McMonnies (Australia), José Joaquín Ugarte, Santiago Ried (Chile), Stephen Crosswell, Eva Crook-Santner (China and Hong Kong), Carolina Pardo (Colombia), Gerardo Villegas-Calderon, Mayte Garcia Bulle (Mexico) and Darrell Prescott (U.S.).
[2] Cleary Gottlieb Steen & Hamilton, CRA International, *Internet Sales of Luxury Products – White Paper Submitted to the European Commissioner for Competition on Behalf of LVMH*, September 2008. Available here: http://ec.europa.eu/competition/sectors/media/lvmh_contribution.pdf
[3] ***Intra-brand competition*** refers to competition that takes place among retailers or distributors of the same brand. In contrast, ***inter-brand competition*** refers to competition among different brands.
[4] In, e.g., Chile, vertical restraints do not give rise to any concerns under competition law below the level of dominance.
[5] Australia, Chile, China, Colombia, the EEA, Hong Kong, Mexico and the U.S.

II. European Union

A. The Framework of Competition Law in Europe

Within the EU, competition law is regulated both at EU level and by each of the 28 EU Member States.[6] Both the additional countries forming part of the European Economic Area (EEA)[7] and Switzerland have very similar rules.[8] In principle, compliance with EU competition law will also mean compliance with the relevant national competition laws of the EU/EEA Member States and of Switzerland. However, and as demonstrated below, in some instances practice at the national level diverges in material respects from the approach of the European Commission (EC) or the General Court and the European Court of Justice (together, the EU courts). Awareness of and compliance with the relevant EU rules and their application at the national level is crucial for companies doing business in Europe, as sanctions can be severe.[9]

The rules on vertical agreements in the EU have a component that is absent from other competition law regimes: the single market objective. The aim of this unique policy objective is to create a single European market, free of any internal barriers to trade, among other things, to allow customers to have complete freedom to purchase products or services from any reseller within the EU. As a result, any restrictions that might hamper that objective, such as resale price restrictions that would reduce or eliminate price competition between competing retailers or territorial restrictions, have always been viewed critically by the EC and the EU courts.

1. The Rules Applicable to Distribution Agreements under EU Competition Law

The key provision of EU competition law governing distribution agreements is found in article 101(1) of the Treaty on the Functioning of the European Union (TFEU), which prohibits all agreements, decisions and practices between undertakings that have as their object or effect the restriction or distortion of competition within the internal market. To be caught by the prohibition in article 101(1), there must be an appreciable effect on competition and an effect on trade between Member States.[10] An agreement that infringes article 101(1) is automatically null and

[6] The 28 Member States are Austria, Belgium, Bulgaria, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, the Netherlands, Poland, Portugal, Romania, Slovakia, Slovenia, Spain, Sweden and the United Kingdom.
[7] The EEA comprises the EU Member States, as well as Iceland, Liechtenstein and Norway.
[8] Switzerland is not an EEA country and maintains its own competition law, which is closely modeled after the EU rules.
[9] The EC has the power to impose fines of up to 10 percent of the annual worldwide group turnover on the infringing undertakings. In addition, relevant clauses, or even entire agreements, that fall foul of the applicable rules may be invalid and unenforceable (article 101(2) of the Treaty on the Functioning of the European Union (TFEU)). National authorities have similar powers to impose sanctions (and most enforcement in this area takes place at the national level). Moreover, resellers or customers harmed by any infringement of competition law may seek damages from the infringers in national courts.
[10] The EC has published a notice on when an agreement has an appreciable effect on competition (*Commission Notice on agreements of minor importance – available here*: http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014XC0830(01)&from=EN). The EC has also published guidance on when agreements may fall under the Notice on agreements of minor importance – a copy of the EC guidance is available here: http://ec.europa.eu/competition/antitrust/legislation/de_minimis_notice_annex.pdf. The EC has also published guidance on the circumstances in which an agreement will or will not have an effect on trade between Member States (*Guidelines on the effect on trade concept* – available here: http://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52004XC0427(06)).

void under article 101(2) of the TFEU, unless the parties can show that the benefits arising as a result of the agreement outweigh any negative effect on competition, in accordance with article 101(3).[11]

The rules of EU competition law governing distribution agreements are complex, and stricter in many respects than those applicable in the U.S. and elsewhere across the globe, given the EU's single market objective. Recognizing, nonetheless, that vertical agreements tend to raise concerns only where inter-brand competition is already weak, the EC has adopted legislation[12] that provides a "safe harbor" under which a large number of vertical agreements will be exempt from the application of article 101(1), provided the following cumulative conditions are met:

i. the agreement is a vertical agreement; typically, an agreement between a supplier and a retailer;[13]
ii. the primary purpose of the agreement is the sale of goods or services;[14]
iii. the market share of the supplier on the market on which it supplies the relevant goods or services does not exceed 30 percent;[15]
iv. the market share of the buyer on the market on which it purchases the relevant goods or services does not exceed 30 percent;[16] and
v. the agreement does not contain any of the so-called "hardcore" restrictions set out in article 4 of the Verticals Regulation.

For the purposes of this chapter, it is worth noting that the list of hardcore restrictions provided in article 4 includes:

i. resale price maintenance (RPM);[17]
ii. territorial and customer restrictions (unless expressly permitted);[18] and
iii. restriction of active or passive sales to end users by members of a selective distribution system; and
iv. restriction of cross-supplies between distributors within a selective distribution system, including between distributors operating at different levels of trade.[19]

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[11] Article 101(3) of the TFEU provides that the prohibition in article 101(1) may be set aside in the case of agreements that "*contribute to improving the production or distribution of goods or to promoting technical or economic progress, while allowing consumers a fair share of the resulting benefit, and which [do] not: (a) impose on the undertakings concerned restrictions which are not indispensable to the attainment of these objectives; (b) afford such undertakings the possibility of eliminating competition in respect of a substantial part of the products in question.*"

[12] EC Regulation (EU) No 330/2010 of 20 April 2010 on the application of article 101(3) of the Treaty on the Functioning of the European Union to categories of vertical agreements and concerted practices (the ***Verticals Regulation***) – available here: http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2010:102:0001:0007:EN:PDF.

[13] Vertical agreements are defined as follows in the Verticals Regulation: an agreement or concerted practice entered into between two or more undertakings each of which operates, for the purposes of the agreement or the concerted practice, at a different level of the production or distribution chain, and relating to the conditions under which the parties may purchase, sell or resell certain goods or services (see article 1(1)(a) of the Verticals Regulation).

[14] Article 1(1) of the Verticals Regulation.

[15] Article 3 of the Verticals Regulation.

[16] Article 3 of the Verticals Regulation.

[17] Article 4(a) of the Verticals Regulation.

[18] Article 4(b) of the Verticals Regulation.

[19] Article 4(a)-(d) Verticals Regulation. In addition, the restriction, agreed between a supplier of components and a buyer who incorporates those components, of the supplier's ability to sell the components as spare parts to end users or to repairers or other service providers not entrusted by the buyer with the repair or servicing of its goods is also considered a hardcore restriction of competition under the Verticals Regulation (article 4(e)).

Agreements containing any hardcore restrictions are null and void under EU competition law, and will likely attract significant fines in the case of an investigation by the EC or national competition authorities.[20]

In addition to the list of hardcore restrictions in article 4, article 5(1) of the Verticals Regulation contains a list of restrictions that, while not considered hardcore, will nonetheless not be covered by the safe harbor provided by the Verticals Regulation. However, the Verticals Regulation, and thus the safe harbor, may continue to apply to the remainder of the relevant agreement if such restrictions are severable from the rest of the agreement (and the relevant conditions for application of the safe harbor mentioned above are met). These so-called excluded restrictions are (i) non-compete obligations the duration of which exceeds five years or is indefinite; (ii) post-termination obligations on the buyer to continue manufacturing, purchasing, selling or reselling the relevant goods or services; and (iii) obligations on members of a selective distribution agreement not to sell the brands of particular competing suppliers.

2. Recent Trends in Enforcement of Distribution Agreements under EU Competition Law

Despite a generally strict approach to vertical agreements, there has been very little enforcement action at the EC level in relation to distribution agreements in recent years.[21] In fact, to date, enforcement has mainly taken place at the national level, with the unfortunate side effect of, at times, causing varying and potentially inconsistent approaches between enforcement by the EC and the EU courts and enforcement by the national competition authorities. However, very recently, the EC appears to have stepped up enforcement in this area; in particular, as regards restrictions of online sales.[22]

Below is an overview of the most common restrictions that can give rise to potential concerns in distribution agreements, and how such restrictions are typically viewed by the EC and certain national competition authorities.

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[20] It is possible to justify restrictions under article 101(3) of the TFEU, provided that the agreement containing such restrictions gives rise to sufficient benefits to outweigh any negative effect on competition arising from the agreement. This applies to any type of restrictions, including hardcore restrictions. However, in the case of hardcore restrictions, this is very much a theoretical possibility. The guidelines accompanying the Verticals Regulation state explicitly that "*it is ... presumed that the agreement is unlikely to fulfill the conditions of Article 101(3)*" (paragraph 47, Commission Notice Guidelines on Vertical Restraints, 10 May 2010 (Guidelines on Vertical Restraints)).

[21] In fact, the last time the EC imposed a fine in a case involving vertical restrictions was in 2003, when it imposed a fine of €149 million on Nintendo, for taking action to prevent exports of games consoles from the UK to the Netherlands and Germany. On appeal, the fine imposed on Nintendo was reduced to €119 million (Case T-13/03 *Nintendo v Commission* [2009] ECR II-975, [2009] 5 CMLR 1421.

[22] At the beginning of December 2013, the EC conducted a string of dawn raids targeting consumer electronics manufacturers suspected of restricting online sales (http://europa.eu/rapid/press-release_MEMO-13-1106_en.htm). It remains to be seen to what extent this investigation signals the start of more active enforcement efforts by the EC in this area.

B. Pricing Issues

1. Fixing the Resale Price/Distributor Margin

For the purposes of EU competition law, distributors must be free to set their own prices, independently of their suppliers. As such, any attempts by suppliers to (directly or indirectly) fix the prices at which distributors sell their products, i.e., the resale price, are classed as hardcore restrictions. The concept of RPM is interpreted broadly under the applicable EU rules and includes:

i. fixing the distribution margin;
ii. fixing the maximum level of discount the distributor can grant customers;
iii. making the grant of rebates or reimbursement of promotional costs by the supplier subject to the observance of a given price level;
iv. linking the prescribed resale price to the resale price of competitors; and
v. threats, intimidation, warnings, penalties, delay or suspension of deliveries or contract terminations in relation to observance of a given price level.[23]

Similarly, a supplier's policy to impose restrictions on the price at which a distributor may advertise a product or service, even where the actual sales price in store is not restricted (a so-called minimum advertised price (MAP) clause), would likely be treated as a hardcore restraint similar to RPM.[24]

Despite its hard-line approach to RPM, the EC recognizes that RPM can give rise to efficiencies in a limited number of circumstances, e.g.:

i. *new product launches*: the Verticals Guidelines explicitly state that "*RPM may be helpful during the introductory period of expanding demand to induce distributors to better take into account the manufacturer's interest to promote the product … RPM may provide the distributors with the means to increase sales efforts and if the distributors on this market are under competitive pressure this may induce them to expand overall demand for the product and make the launch of the product a success, also for the benefit for consumers*";[25] and
ii. *pre-sales services:* in some cases, the extra margin provided by RPM may allow retailers to provide (additional) pre-sales services; in particular, in the case of complex or experience products. Where enough customers take advantage of such services to make their choice but end up purchasing at a lower price with retailers that do not provide such

[23] Paragraph 48 of the Vertical Guidelines. See also below in relation to recommended prices.
[24] Paragraph 48 of the Vertical Guidelines. The guidelines state that price fixing may be made more effective when "*combined with measures which may reduce the buyer's incentive to lower the resale price, such as the supplier printing a recommended resale price on the product*". While there is limited enforcement of so-called MAP clauses in the EEA, the UK competition regulator recently adopted an infringement decision in relation to such a clause. Following a 2011 market study in the mobility aids sector, the UK competition regulator issued an infringement decision to UK-based mobility aids manufacturer Pride Mobility Products Limited for entering into vertical agreements in breach of UK competition law with some of its retailers, which prevented the retailers from advertising below Pride's recommended retail prices. The Office of Fair Trading (OFT) was concerned that, by limiting web discounting, the agreements prevented consumers from obtaining the best prices. No fines were imposed, as the parties' combined turnover was less than £20 million in the year preceding the infringement and the parties thus fell within the immunity given for "small agreements" under UK competition law. A copy of OFT's decision is available here: https://www.gov.uk/cma-cases/investigation-into-agreements-in-the-mobility-aids-sector.
[25] Paragraph 225 of the Vertical Guidelines.

services (and hence do not incur related costs), high-service retailers may reduce or eliminate these services to prevent such free-riding at the distribution level. However, parties will have to convincingly demonstrate that an RPM agreement can be expected to not only provide the means but also the incentive to overcome possible free-riding between retailers on these services and that the pre-sales services benefit consumers.

2. Maximum Prices

Nothing under EU competition law prohibits suppliers from imposing maximum resale prices on distributors (provided that they do not amount to a fixed or minimum sale price as a result of pressure from, or incentives offered by, any of the parties) or from requiring distributors to pass on certain minimum discounts to their customers where the market share of each of the parties to the agreement does not exceed the threshold under the Verticals Regulation.[26]

3. Recommended Retail Prices

Under EU competition law, resale price recommendations are permitted below the 30 percent safe harbor provided for in the Verticals Regulation.[27] Provided a supplier provides its distributor with genuine recommendations or suggestions as to a relevant product's or service's retail price, i.e., the price recommendations may be departed from and do not amount to *de facto* fixed or minimum prices as a result of pressure from, or incentives provided by, any of the parties, recommended or suggested resale prices are permitted under EU competition law.[28] Above the 30 percent safe harbor, an important factor in the assessment of recommended resale prices is the market position of the supplier – the stronger the market position, the higher the risk that a recommended resale price leads to a more or less uniform application of that price level by resellers. They may find it difficult to deviate from what they perceive to be the preferred resale price proposed by such an important supplier in the market.[29]

It is important to note in this respect that recommended prices are an area of increasing controversy, with some Member States taking a much stricter approach than that set out in the Verticals Regulation and Vertical Guidelines. In a recent discussion paper, the German Bundeskartellamt (BKA) warned that "*recommended prices … could act as a reference point for co-ordination towards a collusive market balance …*"[30]. In addition, in recent cases, BKA has treated cases where recommended prices are combined with monitoring of commercial partners or actual pressuring of commercial partners (without any coercion) to comply with the recommended

[26] Article 4(a) of the Verticals Regulation. See also paragraph 226 of the Vertical Guidelines.
[27] Article 4(a) of the Verticals Regulation, paragraphs 48 and 226 of the Vertical Guidelines.
[28] For example, in 2001, Volkswagen was fined €30.96 million by the EC for trying to stop dealers from departing from its non-binding price recommendations (*Volkswagen II*, EC Decision of 29 June 2001, OJ [2001] L 262/14). While the EC's decision was eventually annulled on appeal to the European Court of Justice, this was unrelated to whether or not price recommendations fall foul of the EU competition rules but was on the basis that the EC had incorrectly concluded that there had been an agreement between the parties to the case (see Case C-74/04 P *European Commission v Volkswagen* [2006] ECR I-6585, [2008] 4 CMLR 1297).
[29] Paragraph 228 of the Vertical Guidelines.
[30] Tagung des Arbeitskreises Kartellrecht, 10 Oktober 2013, Vertikale Beschränkungen in der Internetökonomie, p.9.

prices (without any coercion) as equivalent to RPM.[31] Moreover, in a recent case, the German Federal Supreme Court held that a single contact commenting on a dealer's price was not economically comprehensible, even where no pressure was applied on the dealer.[32] Worryingly, in some cases, such findings appear to have been made based on witness evidence alone.[33] A similar strict approach to recommended prices is currently being adopted by the national competition authorities in both Switzerland[34] and France.[35]

4. Minimum Advertised Price

The treatment of MAP clauses for the purposes of EU competition law is addressed above, in "Fixing the Resale Price/Distributor Margin".

C. Vertical Non-price Restraints

Whether certain types of non-price restrictions in distribution agreements are permissible under EU competition law depends on the particular type of distribution model adopted by the relevant undertaking. Generally speaking, three types of distribution models can be distinguished:

i. *open distribution* refers to a distribution model with no restrictions imposed by the supplier as to the territory into which, and the customers to whom, a distributor may sell;
ii. *exclusive distribution* refers to a distribution model in which a supplier agrees to sell its products only to one distributor for resale in a particular territory or only to a particular customer group. At the same time, the distributor is usually limited in its active selling into other (exclusively allocated) territories. A supplier may also reserve certain territories or customer groups to itself;[36] and
iii. *selective distribution* refers to a distribution model without territorial restrictions in which the supplier decides to sell products to distributors selected according to certain criteria, like quality, number or location.[37]

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[31] *Ciba Vision*: follow-ups on price recommendations combined with an internal monitoring system were treated as RPM (Activity Report of the Bundeskartellamt 2009/2010, documentary volume, p. 98); *WALA Heilmittel GmbH*: the BKA imposed a fine of €6.5 million for RPM (pressuring resellers to follow RRPs) (BKA press release of 31 July 2013).
[32] BGH, 06.11.2012 - KZR 13/12 (a copy of the judgment is available here: http://juris.bundesgerichtshof.de/cgi-bin/rechtsprechung/document.py?Gericht=bgh&Art=en&nr=62438&pos=0&anz=1).
[33] *TTS Tooltechnic case*: BKA fined TTS €8.2 million for encouraging resellers to respect the recommended resale price and for making threats that failure to observe the recommended retail price would lead to less advantageous contract conditions or termination of distribution contracts. Note that the BKA did not find any written evidence of RPM but established RPM solely on the basis of evidence obtained from witness interviews (BKA press release of 20 August 2012).
[34] For example, where a sufficient number of dealers (e.g., 30 percent) follow a recommended resale price, this could be construed as evidence of RPM, even in the absence of any evidence of pressure or threats imposed on distributors.
[35] Similarly, in France, a recommended price will amount to a *de facto* fixed price (and thus RPM) imposed by a supplier where the price recommendation is combined with a monitoring mechanism and customers in fact adhere to the recommendation.
[36] Paragraph 151ff of the Vertical Guidelines.
[37] Article 1(e) of the Verticals Regulation, paragraph 174ff of the Vertical Guidelines. In fact, it is the existence of an obligation on authorized dealers not to make sales to unauthorized resellers that turns an open distribution system into a closed distribution system.

1. Open Distribution

Where a supplier is operating an *open* distribution model, any kind of territorial or customer restrictions on the distributor are typically treated as hardcore restrictions, subject to the exceptions set out in article 4(b)(i)-(iv) of the Verticals Regulation. The rationale for this is that territorial restrictions, such as export bans, hinder the integration of the single European market and are therefore regarded as *per se* illegal.[38] Territorial or customer restrictions can be achieved both by direct and indirect means. Indirect means include measures aimed at inducing a distributor not to sell to certain customers or into certain territories, e.g., by refusing or reducing bonuses or discounts, terminating supply, reducing supply or limiting supplies to the demand within the allocated territory or customer group, threat of contract termination, requiring higher prices for products to be exported, limiting the proportion of sales that can be exported or a profit pass-over obligation.[39]

2. Exclusive Distribution

Where a supplier and a distributor are operating in an *exclusive* distribution model, the supplier can restrict so-called *active sales* by one distributor into the exclusive territory of another distributor or to the exclusive customer group of another distributor or a territory or customer group reserved to itself. However, the supplier cannot limit *passive sales*:

i. *active sales* means actively approaching individual customers by, for instance, direct mail, including the sending of unsolicited emails, or visits; or actively approaching a specific customer group or customers in a specific territory through advertisement in media, on the internet or other promotions specifically targeted at that customer group or targeted at customers in that territory. Advertisement or promotion that is only attractive for the buyer if it (also) reaches a specific group of customers or customers in a specific territory, is considered active selling to that customer group or customers in that territory;[40] and
ii. *passive sales* means responding to unsolicited requests from individual customers, including delivery of goods or services to such customers. General (as opposed to targeted) advertising or promotion that reaches customers in other distributors' exclusive territories or customer groups but is a reasonable way to reach customers outside those territories or customer groups, e.g., to reach customers in one's own territory, are considered passive selling. Sales over the internet are generally considered to constitute passive sales for the purposes of the EU competition rules.

If a supplier operates a distribution network that includes both exclusive and non-exclusive distributors, the distinction between "active" and "passive" sales can lead to complicated situations. For example, if a supplier has an exclusive distributor in France and a non-exclusive distributor in Germany, the German distributor can be prohibited from actively targeting French customers, but the French distributor cannot be restricted from making any sale, active or passive, to German customers.

[38] Article 4(b) of the Vertical Regulation, paragraph 50 of the Vertical Guidelines.
[39] Paragraph 50 of the Vertical Guidelines.
[40] Paragraph 51 of the Vertical Guidelines.

3. Selective Distribution

In a selective distribution system, the supplier restricts sales of its product to those distributors satisfying certain criteria. Such admission criteria can be *qualitative* (e.g., requirements regarding the types of outlets in which the products may be sold or requirements regarding the presence of qualified staff to advise customers, after-sales services, etc.) or *quantitative* (e.g., limitations on the number of distributors in a given area, a requirement to order a minimum amount of product or to achieve particular level of sales of the supplier's product).

Purely qualitative selective distribution is, in general, considered to fall outside article 101(1) of the TFEU altogether, provided the following three conditions are met:

i. the nature of the product in question requires a selective distribution system, in the sense that such a system must constitute a legitimate requirement having regard to the nature of the relevant product, to preserve its quality and ensure its proper use;
ii. resellers are chosen on the basis of objective criteria of a qualitative nature that are laid down uniformly for all and made available to all potential resellers and are not applied in a discriminatory manner; and
iii. the criteria laid down do not go beyond what is necessary.[41]

Qualitative and quantitative selective distribution is exempted by the Verticals Regulation as long as the market shares of both the supplier and buyer do not exceed 30 percent.[42] Outside the safe harbor, an individual assessment of quantitative criteria needs to be carried out, and there is a risk that such criteria would infringe article 101(1) of the TFEU and would not be justifiable under article 101(3) of the TFEU.

This relatively flexible attitude to vertical distribution agreements at EU level is in stark contrast with the approach taken by certain national competition authorities. In fact, selective distribution agreements have come under scrutiny by a number of national competition authorities. In recent years, authorities in Germany and Austria have focused on alleged misuses of selective distribution systems as a means to implement RPM and online sales restrictions. Moreover, the BKA appears to generally call into question the benevolent treatment of selective distribution systems under the Verticals Regulation; in particular, in relation to online sales.[43] As a result, it cannot be excluded that there may be cases in the future where the BKA decides that a selective distribution agreement is not covered by the Verticals Regulation and should be reviewed under article 101(1) of the TFEU or the equivalent national provision instead (with the accompanying risk of the BKA establishing an infringement of such provision) in circumstances where the EC would have considered the relevant agreement to fall within the scope of the Verticals Regulation.

4. Franchising

Franchising describes an arrangement whereby a franchisee will operate a business that is independent from that of the franchisor but that uses the name and know-how of the franchisor. Franchising can be distinguished from conventional distribution systems as franchises typically

[41] Paragraph 175 of the Vertical Guidelines.
[42] Paragraph 176 of the Vertical Guidelines.
[43] 42. Brüssler Informationstagung des FIW, 7 November 2013, Dr. Gunnar Kallfass: Internetvertrieb und vertikale Wettbewerbsbeschränkungen.

involve the franchisor granting a license granted to the franchisee to use the intellectual property rights of the franchisor in return for a fee.

In order for a franchising system to be successful, it is essential that all the franchisees comply with certain uniform common methods imposed by the franchisor. Moreover, given the transfer of intellectual property rights from the franchisor to the franchisee, it is important that the franchisor is able to protect these rights. As such, franchise agreements typically contain a combination of different vertical restraints.

Restrictions in a franchise agreement aimed at protecting the franchisor's intellectual property rights, or aimed at ensuring that all franchise outlets achieve the same standards, typically do not infringe article 101(1) of the TFEU. As regards other vertical restraints contained in franchise agreements that relate to the purchase, sale and resale of goods and/or services within a franchise agreement, such restrictions are exempted by the Verticals Regulation under the conditions set out above.[44]

D. Horizontal Restraints

Distribution relationships can, in some instances, also give rise to horizontal competition concerns. In particular, there is a risk that a supplier could be found to facilitate the exchange of competitively sensitive information between retailers (so-called "hub and spoke" arrangements). If a supplier is found to have knowingly acted as a conduit for an exchange of competitively sensitive information between two retailers, both the supplier and the retailers could face high fines, as well as private damages actions from third parties that have suffered harm as a result of such exchanges of information.

While the EC has taken infringement decisions in a number of cases involving hub and spoke information exchanges, e.g., where industry associations or consulting firms facilitated the information exchange,[45] national competition authorities have also dealt, or are dealing, with a number of hub and spoke cases. For example, the UK's OFT has imposed fines in a number of hub and spoke cases involving retailers. In 2003, the OFT fined a number of companies, including JJB Sports plc, Manchester United plc and Umbro Holdings plc, for their alleged involvement in fixing the prices of replica football kits manufactured by Umbro.[46] On appeal to the UK Court of Appeal, the court developed a three-limbed test for determining that a hub and spoke arrangement is in breach of the competition rules:

i. Retailer A discloses to supplier B its future pricing intentions in circumstances where A may be taken to *intend* that B will make use of that information to influence market conditions by passing that information to other retailers.
ii. B does pass that information to retailer C in circumstances where C may be taken to know the circumstances in which the information was disclosed by A to B.
iii. C does in fact use the information in determining its own future pricing intentions.

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44 Paragraph 190 of the Vertical Guidelines.
45 See e.g., Case T-99/04 *AC-Treuhand AG v Commission* [2008] ECR II-01501).
46 The OFT's decision was upheld on appeal to the UK Competition Appeal Tribunal and the UK Court of Appeal (*JJB Sports v OFT* (Case 1102/1/1/03). See also *Tesco v Office of Fair Trading* [2012] CAT 31, judgment of 20 December 2012.

It is worth emphasizing that the test applied by other national competition authorities is not as strict. At least for the purposes of the EU competition rules, satisfying the first two limbs of the above test will suffice to establish a breach of article 101(1) of the TFEU in the form of a hub and spoke arrangement, as EU competition law contains a rebuttable presumption that companies will act on competitively sensitive information disclosed to them.[47]

E. Issues with Internet Sales

In parallel with the growth of e-commerce in recent years, restrictions on sales over the internet have come under increasing scrutiny both at EU and the national level. As the EC states in the Vertical Guidelines: "*the internet is a powerful tool to reach a greater number and variety of customers than by more traditional sales methods … in principle, every distributor must be allowed to use the internet to sell products*."[48] As a result, the EC takes a very strict view of most types of internet sales restrictions. Outright bans on internet sales are strictly prohibited under EU competition law. For example, in *Pierre Fabre*, a requirement in a distribution agreement that sales of skin care products had to be made in a physical space and in the presence of a qualified pharmacist was held to amount to a *de facto* prohibition of internet sales and therefore to be a hardcore restriction that could not be justified.[49]

In addition to restrictions that impose a total ban on internet sales, the EC will regard the following (more limited) restrictions on internet sales as hardcore restrictions for the purposes of the Vertical Guidelines:

i. a requirement in the supplier's agreement with the distributor that the distributor shall prevent customers located in another territory from viewing its website or shall automatically redirect its customers to the manufacturer's or other distributors' websites;
ii. a requirement in the supplier's agreement with the distributor that the distributor shall terminate consumers' transactions over the internet once the credit card data reveals an address that is not within the retailer's territory;
iii. a requirement in the supplier's agreement with the distributor that the distributor shall limit its proportion of overall sales made over the internet. This does not exclude the supplier requiring, without limiting the online sales of the distributor, that the buyer sells at least a certain absolute amount (in value or volume) of the products offline to ensure an efficient operation of its brick and mortar shop. However, it is permitted to impose a requirement for a minimum percentage of sales to be achieved offline. This means, e.g., that a supplier cannot impose a requirement that a distributor shall not sell more than 20 percent of products online, but the supplier can require a distributor to generate sales of at least, e.g., €75,000 in-store;[50] and

[47] See e.g., paragraph 62 of the Commission's Guidelines on the applicability of article 101 of the TFEU to horizontal co-operation agreements (OJ 2011 C11/1, as corrected by OJ 2011 C33/20) and Case C-8/08 *T-Mobile Netherlands and Others v Raad van bestuur van de Nederlanse Medeingingsautoriteit* [2009] ECR I-04529.
[48] Paragraph 52 of the Vertical Guidelines.
[49] Case C-439/09 *Pierre Fabre Dermo-Cosmétique*, 13 October 2011, French Court of Appeal, decision of 5 January 2013 in RG nº 2008/23812.
[50] Such an absolute amount of required offline sales can be the same for all buyers, or determined individually for each buyer on the basis of objective criteria, such as the buyer's size in the network or its geographic location.
Paragraph 52(a)-(d) of the Vertical Guidelines.

iv. dual pricing is strictly prohibited: this means that a supplier cannot charge a higher price for products intended to be resold by the distributor online than for products intended to be resold offline (e.g., charging the same distributor €100 for products sold online and €80 for products sold in-store). This does not exclude the supplier agreeing with the distributor on a fixed fee (as opposed to a variable fee, where the sum increases with the realized offline turnover, as this would amount indirectly to illegal dual pricing) to support the latter's online or offline sales efforts. For example, a supplier can offer support fees for in-store demonstrations, for employees that have attended training in relation to a particular product or to support after-sales services. [51]

The EC does, however, permit certain restrictions in relation to internet sales and, in particular, it permits the imposition of quality standards for websites on which a retailer may resell goods (just as a supplier may require quality standards for a brick and mortar shop). For example:

i. a supplier can impose a requirement that a dealer must have one or more brick and mortar shops or showrooms before it can become part of the dealer network;[52] and
ii. as regards the use of third party platforms, a supplier can require that its dealers only use such platforms to distribute products to the extent that the platform complies with the agreed standards and conditions regarding use of the internet. For example, if the dealer's website is hosted by a third party platform, the supplier can require that customers enter the distributor's website, not via a site carrying the name or logo of that third party platform.[53] However, recent case law at the national level shows sales restrictions regarding third party platforms need to be assessed carefully. Pursuant to the most recent practice of the BKA, a blanket prohibition on third party platform sales will likely not be permitted.[54] However, prohibitions of sales on third party platforms would be permitted where such platforms do not provide sufficient safeguards as to the quality of the products and identity of the sellers, or where such platforms could facilitate sales of counterfeited products and therefore tarnish the supplier's brand image.[55]

It is important to emphasize that any quality standards imposed on retailers must not be unduly restrictive, in that they must be equivalent to criteria imposed for bricks and mortar sales. This does not mean that the online and bricks and mortar criteria must be identical, but they must pursue the same objectives and achieve comparable results, with any differences between the criteria justified by reference to the different nature of the two distribution modes.[56] It is important to be aware that some national competition authorities, particularly in France and Germany, engage in a detailed analysis of any restrictions of internet sales, including a side-by-side

[51] Paragraph 52(a)-(d) of the Vertical Guidelines.
[52] Paragraph 54 of the Vertical Guidelines. As such, a supplier is in fact able to exclude pure online retailers from its network.
[53] Paragraph 54 of the Vertical Guidelines.
[54] There are currently a number of ongoing investigations into restrictions of third party platform sales in Germany. In September 2013, the Berlin Court of Appeal confirmed that a prohibition of third party platform sales may be permitted where there is a need to protect brand image, recognizing that eBay tends to have a reputation as a "flea market" and that sales via eBay negatively impact brand image. However, a restriction of sales on eBay's platform would not be permissible if a supplier sold the same products on other discounter websites.
[55] Ibid.
[56] Paragraph 56 of the Vertical Guidelines. For example, specific guidelines may have to be formulated to ensure secure online payments or to set up sales helpdesks for online sales (paragraph 56 of the Vertical Guidelines).

comparison of the criteria governing online and bricks and mortar sales, to ensure that any restriction of sales over the internet is justified by the difference in the two distribution models.[57]

In conclusion, restrictions on internet sales are under close scrutiny in many jurisdictions, and national authorities are concerned to ensure that online restriction are not used as a potential mechanism to maintain higher prices for sales over the internet.[58] While restrictions on internet sales are permissible in certain circumstances, such restrictions need to be carefully assessed on a case-by-case basis and reviewed periodically (and, where necessary, updated) to reflect changes and developments in the retail environment.

III. Americas

USA

A. The Framework of US Antitrust Law

Under federal law, the primary antitrust statute governing agreements in restraint of trade is section 1 of the Sherman Act, 15 U.S.C. § 1.[59] Section 1 prohibits agreements that unreasonably restrain trade. A violation of section 1 requires proof of three elements: (i) an agreement; (ii) that unreasonably restrains trade; and (iii) that affects interstate commerce.[60] A few types of agreement – including price fixing, bid rigging and certain boycotts – once established, are considered per se illegal under section 1. The *per se* rule forecloses any analysis of the purpose of the agreement once established or its effect on competition. Other potentially anti-competitive practices challenged under section 1 are evaluated under the "rule of reason," which requires weighing any actual or potential anti-competitive effects within a defined relevant market caused by the challenged conduct against its potential pro-competitive benefits.[61] A lack of market power is often sufficient to find many types of vertical restraints lawful under the rule of reason.

B. Suggested Pricing Issues

In an effort to better control their brands and images, many fashion and luxury goods makers wish to implement price controls to restrict the prices at which retailers may sell their products.

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[57] Tagung des Arbeitskreises Kartellrecht, 10 Oktober 2013, Vertikale Beschränkungen in der Internetökonomie, p. 23.

[58] For example, the German BKA recently stated that it wanted the BKA to become a "pioneer" in regulating online commerce. In addition, in December 2012, the French competition authority imposed a fine of €900,000 on Bang & Olufsen for restricting the distributors in their selective distribution system from selling Bang & Olufsen products online. The French competition authority underlined that one of the harmful effects of banning online sales was that customers were deprived of lower sales and saw their choices limited. A copy of the decision is available here: http://www.autoritedelaconcurrence.fr/user/avisdec.php?numero=12-D-23.

[59] Sherman Act, 15 U.S.C. § 1 (2012).

[60] Realcomp II, Ltd. v. FTC, 635 F.3d 815, 824 (6th Cir. 2011); see also, *Santana Products v. Bobrick Washroom Equipment*, 401 F. 3d 123, 131-32 (3d Cir.), *cert. denied*, 126 S. Ct. 734 (2005).

[61] See, e.g., *National Society of Professional Engineers v. United States*, 435 U.S. at 692 (1978); *Geneva Pharms. Tech. Corp. v. Barr Labs.*, 386 F.3d 485, 507 (2d Cir. 2004). There are two less common means of antitrust analysis. "Quick look" analysis is a truncated rule of reason analysis – it is used where there is an obvious adverse effect on competition and no pro-competitive benefits. It does not require a plaintiff to establish every aspect of anticompetitive effects before the burden shifts to the defendant to prove offsetting procompetitive effects. See, e.g., *Indiana Fed'n of Dentists*, 476 U.S. 447, 459-61 (1986). Separately, an affirmative demonstration that the challenged restraint caused actual competitive harm may obviate the need for a full rule of reason analysis. See, e.g., *Toys "R" Us, Inc. v. FTC*, 221 F.3d 928 (7th Cir. 2000).

These controls often take the form of a suggested retail price policy or a required minimum price policy. The law on these restrictions has evolved significantly over time and become more permissive. However, because the law in this area is still relatively unsettled, companies do expose themselves to the risk of antitrust liability when they implement such programs, especially in certain states of the U.S., or at the federal level, if the resale pricing policy is part of a horizontal price restraint among competitors.

Resale price maintenance is an agreement between a supplier and a reseller about the price the reseller may charge its own resale customers. Resale price maintenance can take different forms. It can involve setting a price floor below which sales cannot occur (minimum resale price maintenance), a price ceiling above which sales cannot occur (maximum resale price maintenance), or a fixed price. Suggested pricing, as the name implies, is the practice of providing a retailer with a *suggested* retail price for the manufacturer's product. Unlike resale price maintenance, in a true suggested pricing arrangement, the retailer is permitted to deviate from the suggested price.

Until fairly recently, agreements that set minimum resale prices were *per se* illegal under federal law. In 2007, the Supreme Court in *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[62] overruled the *per se* standard, and adopted the rule of reason analysis for minimum resale price maintenance claims, harmonizing the minimum resale price maintenance standard with maximum resale price maintenance, which was given the rule of reason treatment 10 years prior.[63]

Under the facts of the case, Leegin Creative Leather Products, a manufacturer of leather accessories, implemented a minimum pricing policy under which it would refuse to deal with or would terminate those retailers that did not comply with the policy. When Leegin discovered that retailer Kay's Kloset was selling below the set minimum resale price, it terminated the supply relationship. PSKS, Kay's parent company, brought suit, claiming that Leegin's policy was a *per se* illegal minimum resale price maintenance policy. The Supreme Court rejected PSKS's argument and found that minimum RPM policies would now be assessed under the far less stringent rule of reason. The court held that there could be several pro-competitive rationales for an RPM policy, including promoting inter-brand competition, encouraging non-price competition among retailers, and discouraging free riding.

Federal courts since *Leegin* perform a full rule of reason analysis of the pro- and anti-competitive effects of a resale price maintenance arrangement to determine if it unreasonably restrains trade.[64] This has presented plaintiffs with an often insurmountable barrier to finding an RPM policy illegal under federal antitrust law.[65] When only a few manufacturers lacking market power adopt resale price maintenance, a court applying federal law is unlikely find the practice

[62] See *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*, 551 U.S. 877 (2007).
[63] *See State Oil Co. v. Khan*, 522 U.S. 3, 18 (1997) (ruling that there is insufficient economic justification for *per se* invalidation of vertical maximum price fixing).
[64] The court in *Leegin* identified specific factors relevant to the inquiry, including: (1) the number of manufacturers engaged in the practice in the market; (2) whether the restraint comes at the behest of retailers or the manufacturer; and (3) whether the manufacturer or retailer driving the practice possesses market power.
[65] See e.g., *Bel Canto Design, Ltd. v. MSS HiFi, Inc.*, 2012 U.S. Dist. LEXIS 86628 (S.D.N.Y. 20 June 2012) (granting a motion to dismiss because the plaintiff had failed to establish market power); *Spahr v. Leegin Creative Leather Products, Inc.*, No. 2:07-CV-187, 2008 WL 3914461 (E.D.Tenn. 2008) (dismissing a retailer's complaint because the retailer had failed to show anti-competitive effects).

unlawful. In contrast, where a retailer with a high market share encourages manufacturers to adopt a minimum RPM policy, a court is far more likely to find the practice unlawful.[66]

In addition to courts, federal agencies have also altered their enforcement policies in the wake of Leegin. For example, in 2008, in light of *Leegin*, the Federal Trade Commission (FTC) modified a pre-*Leegin* order against fashion design company Nine West Group to allow the company to engage in resale price maintenance.[67] The FTC applied *Leegin*, noting that "Nine West has demonstrated that it lacks market power and that Nine West itself is the source of the resale price maintenance."[68] The modified order overruled a previous FTC order that had prohibited Nine West from threatening or penalizing dealers that sold below the company's designated retail prices.

Although resale price maintenance is no longer a *per se* violation under federal law, some states and state attorneys general have taken the position that the *Leegin* decision does not affect state antitrust law. For example, in 2009, Maryland passed a law in direct response to the *Leegin* decision, which declared RPM to be *per se* illegal under Maryland's antitrust statute.[69] In 2008, Illinois, Michigan and New York sued furniture manufacturer Herman Miller, alleging that the company's RPM policy was a *per se* unlawful RPM policy under their respective state antitrust statutes.[70] The parties quickly entered into a consent decree to settle the case. Likewise, the California attorney general has aggressively pursued RPM as a *per se* violation of California's antitrust statute, the Cartwright Act. In 2010, the California attorney general filed suit in the state court, alleging that a skin care manufacturer, Dermaquest, committed a *per se* violation of the Cartwright Act by entering into agreements with sellers prohibiting them from reselling below the firm's suggested retail price. The company quickly entered into a consent decree, settling the case.[71] The California attorney general's position was boosted in 2013, when a U.S. District Court in California found RPM still to be *per se* violation under the Cartwright Act.[72]

In the past, states have pursued RPM claims against fashion and luxury goods companies. For example, in 2000, Nine West agreed to settle charges from the FTC, as well as several states, accusing the company of implementing *per se* illegal RPM agreements with its dealers. Although the FTC modified its order in the wake of *Leegin*, this modified order did not affect the state settlements.

Due to the inconsistent treatment of RPM policies under state law, companies considering whether to implement an RPM policy should tread cautiously and consider instead implementing a suggested pricing program. Under the Supreme Court's decision in *United States v. Colgate*, a

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[66] See e.g., *Babyage.com, Inc. v. Toys "R" Us, Inc.*, 2008 U.S. Dist. LEXIS 53918 (E.D.Pa. 15 July 2008) (Online retailers of high-end baby products sued Toys "R" Us, alleging that the company used its market dominance to force baby product manufacturers to impose RPM polices).
[67] *Nine West Gro. Inc.*, 2008 FTC LEXIS 53 (FTC 2008).
[68] *Id.*
[69] MD. COMM. CODE § 11-204.
[70] *New York v. Herman Miller Inc.,* No.08 CV-02977, 2008-2 Trade Cases (CCH) ¶ 76,454 (S.D.N.Y., filed 21 March 2008).
[71] *California v. DermaQuest Inc.*, No. RG10497526 (Cal. Super. Ct., Alameda Cty., 23 February 2010); *see California v. Bioelements, Inc.*, No. 10011659 (Cal. Super. Ct., Riverside Cty., 11 January 2011) (the California attorney general obtained a settlement that required a company called Bioelements to permanently refrain from fixing resale prices for its merchandise, after it filed a complaint alleging that the company engaged in vertical price fixing in *per se* violation of state law by having written contracts with resellers prohibiting accounts from charging more or less than the manufacturer's suggested resale price (MSRP).
[72] *Alan Darush MD APC v. Revision LP, et al.*, CV 12-10296 (C.D.Cal. 10 April 2013).

supplier is permitted to make a unilateral decision to deal or not with its resellers and set the terms on which it will deal.[73] Under the *Colgate* doctrine, it is lawful for a manufacturer to “suggest” a retail price, and then refuse to deal with resellers who do not sell at the suggested price. A suggested retail price set by a manufacturer is considered unilateral conduct, and does not run afoul of the Sherman Act’s prohibition on concerted actions that unreasonably restrain trade.[74] Thus, in such cases, the “agreement” element would not be present for those states that challenge RPM. For example, in *Jeanery, Inc. v. James Jean, Inc.*, the defendant jean manufacturer was sued by a dealer terminated after not complying with the manufacturer’s minimum price requirements.[75] The 9th Circuit overturned a District Court opinion that had found that the manufacturer and competing retailers entered into a conspiracy to fix the resale prices of the manufacturer’s jeans. The 9th Circuit found that there was no agreement, and noted that manufacturers are permitted to announce resale prices and refuse to deal with those retailers who do not comply, without running afoul of the antitrust laws.

Under *Colgate*, a manufacturer’s use of a manufacturer’s suggested resale price (MSRP) is not unlawful, so long as the price is actually “suggested” and not coerced.[76] Coercive conduct by a manufacturer to enforce such a policy is often sufficient evidence for a court to find the policy to be concerted action. A manufacturer may be vulnerable to the charge that a pricing policy is actually coerced where the manufacturer’s conduct in enforcing the policy goes beyond “exposition, persuasion and argument”.[77] The line between coercion and mere suggestion is muddy, however, with courts focusing on a variety of factors. Coercion may include a number of actions, e.g., threats, policing, or the use of sanctions.[78] In addition, some courts have found requisite concerted action where a manufacturer terminates a non-complying retailer after receiving complaints from other retailers about the non-complying retailer.[79]

In sum, although federal courts now treat RPM under the rule of reason, companies – especially those that sell their products nationwide – seeking to implement an RPM policy should be very cautious. Implementing an RPM policy may still expose a company to severe penalties under state law. Thus, often a company’s most prudent course of action if it wishes to control retailer prices is to implement a *Colgate*-style suggested pricing policy. Companies should consult with counsel in creating such policies, to minimize the risk that they will be characterized as an RPM policy.

[73] 250 U.S. 300 (1919).

[74] See *United States v. Colgate & Co.*, 250 U.S. 300 (1919) “In the absence of any purpose to create or maintain a monopoly, the Act does not restrict the long recognized right of trader or manufacturer engaged in an entirely private business, freely to exercise his own independent discretion as to parties with whom he will deal; and, of course, he may announce in advance the circumstances under which he will refuse to sell.”).

[75] *Jeanery, Inc. v. James Jean, Inc.*, 849 F.2d 1148, 1159 (9th Cir. 1988).

[76] See e.g., *id*.

[77] See e.g., *Ezzo’s Invs. v. Royal Beauty Supply*, 94 F.3d 1032, 1035-36 (6th Cir. 1996) (reversing summary judgment for the defendant where the plaintiff introduced sufficient evidence that the defendant threatened the plaintiff with termination if it continued discounting).

[78] *Reebok Int’l*, 120 FTC 230 (1995) (FTC consent order that barred the manufacturer from warning dealers that they were subject to termination or other sanctions if they sold below the minimum resale price).

[79] See e.g., *Consol. Credit Agency v. Equifax, Inc.*, 2004 U.S. Dist. LEXIS 31061, at *22-23 (C.D.Cal. 5 August 2004).

C. Minimum Advertised Price

Fashion and luxury goods makers may also seek to control the prices at which their products are advertised, but not necessarily sold. A MAP is a policy restricting the price at which a product or service may be advertised. This may take the form of a simple prohibition on advertising below a certain price or it may take the form of a cooperative advertising program. A cooperative advertising program is a program under which a supplier provides subsidies to the retailer to promote the supplier's product. In consideration for the subsidy, the supplier may insist that the retailer adhere to an MAP policy.

Under federal law, MAP policies are treated as non-price vertical restraints and governed by the rule of reason.[80] MAP policies that condition the receipt of advertising funds on adherence to the policy have consistently been upheld by courts.[81] Where a MAP policy has enough characteristics of an RPM policy, however, a court may analyze the restraint as an RPM policy. This distinction was more critical before *Leegin*; however, it remains important in states where RPM is still a *per se* violation. Where a MAP policy has the effect of restricting the price at which a retailer may sell the product, then a court is more likely to analyze the policy under an RPM framework. Policies that impose significant penalties for non-compliance with the policy, or policies that restrict not just external advertising, but also advertising within the stores themselves, may be vulnerable to a charge that they are disguised RPM policies.[82] Where, however, a MAP policy expressly permits a retailer to set different prices and where discounted sales actually do occur, there is less risk that the policy will be found unlawful.[83] In order to avoid antitrust liability, retailers seeking to implement a MAP policy should be cautious and ensure that their policies do not have the effect of restricting prices.

D. Vertical Non-price Restraints

Fashion and luxury goods makers may also wish to implement certain non-price vertical restraints. These can take a number of forms, including exclusive distributorships, point of sale restrictions, territorial and customer restrictions, or channel restrictions. Since the Supreme Court's decision in *GTE Slyvania Inc. v. Cont'l TV., Inc.* courts have generally analyzed these restraints under the rule of reason and found them lawful.[84]

Territorial and customer restraints restrict a retailer's ability to sell outside a particular territory or to a particular category of customer. Territorial and customer restrictions are analyzed under the rule of reason, with few decisions finding the restrictions unlawful.[85] Point of sale

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[80] See e.g., *Lake Hill Motors, Inc. v. Jim Bennett Yacht Sales, Inc.*, 246 F.3d 752, 757 (5th Cir. 2001); *Cranfill v. Scott & Fetzer Co.*, 773 F. Supp. 943, 951 (E.D.Tex. 1991).

[81] E.g., *In re Nissan Antitrust Litigation*, 577 F.2d 910 (5th Cir. 1978), cert. denied, 439 U.S. 1072 (1979); *Clinique Lab., Inc.*.
116 F.T.C. 126 (1993).

[82] See *Sony Music Entm't*, No. 971-0070, 2000 FTC LEXIS 40 (10 May 2000) (FTC challenged the MAP programs of several distributors of music. FTC noted that the programs applied to external and in-store price advertising and included severe penalties for non-compliance).

[83] See *U.S. Pioneer Elecs. Corp.*, 115 F.T.C. 446 (FTC 1992).

[84] *Continental Television v. GTE Sylvania*, 433 U.S. 36 (1977). See, *e.g., Ezzo's Invs. v. Royal Beauty Supply*, 243 F.3d 980, 987 (6th Cir. 2001) (finding distribution limitation was a vertical non-price restraint subject to the rule of reason).

[85] See, *e.g., Glacier Optical v. Optique du Monde*, 46 F.3d 1141 (9th Cir. 1995) (the court applied the rule of reason to vertical allocation of territories).

restrictions limit a retailer to selling only from a specified location. Likewise, channel restrictions, which restrict the channels – e.g., mail order, 800 number, internet, brick and mortar – through which a retailer may sell products, are judged under the rule of reason and almost always found reasonable.[86] Unless the manufacturer has market power, territorial, customer, point of sale and channel restrictions will usually be found lawful.[87]

Courts have also applied the rule of reason to exclusive dealing arrangements.[88] Exclusive dealing normally takes the form of an agreement to conduct business with one particular supplier or retailer. For example, a supplier may insist that a retailer not carry any competing brands in its stores. In applying the rule of reason, although courts will analyze barriers to entry and the duration of the agreement, courts place particular emphasis in determining whether the agreement substantially forecloses competition.[89] Where only a small fraction of buyers or sellers are foreclosed from purchasing or selling, and there are ample other outlets for the goods or services, the agreement is unlikely to be found unlawful.[90]

E. Horizontal Restraints

Horizontal restraints refer to competitive restraints between horizontal competitors. Agreements in restraint of trade among horizontal competitors are generally judged far more harshly than vertical restraints and are a primary target of U.S. antitrust enforcement.

Many such restraints are analyzed under the *per se* rule, including agreements among competitors to fix prices, allocate territories/customers or boycott other companies.[91] Although certain practices may be legal when agreed to between non-competing companies – e.g., channel, customer or territorial restrictions – when done in concert with a competitor, they expose a company to a high risk of antitrust liability. To minimize the risk of liability, companies should avoid any implication of agreement and thus avoid sharing competitively sensitive information between competitors.

Manufacturers also risk liability if they facilitate or encourage a horizontal agreement among retailers to fix prices or allocate territories/customers. These agreements are better known as hub and spoke conspiracies. Usually, individual agreements between a manufacturer and retailers are vertical and analyzed as such. However, where the manufacturer acts as a hub and enters into a series of vertical agreements with retailers, such agreements may be actionable where the retailers themselves also come to some agreement and use the manufacturer as a conduit for communications.[92] For example, in *Toys "R" Us v. FTC*, the 7th Circuit upheld an FTC decision

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[86] See, *e.g., H.L. Hayden Co. v. Siemens Med. Sys.*, 879 F.2d 1005 (2d Cir. 1989); *Parkway Gallery Furniture v. Kettinger/Pennsylvania House Group*, 878 F.2d 801 (4th Cir. 1989).
[87] See, e.g., *Ryko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1234 (8th Cir. 1987).
[88] See, e.g., *Omega Envt'l. v. Gilbarco, Inc.*, 127 F.3d 1157, 1162 (9th Cir. 1997); *Ryko Mfg. Co. v. Eden Servs.*, 823 F.2d 1215, 1234 (8th Cir. 1987).
[89] See, e.g., *Toys "R" Us, Inc. v. Fed. Trade Comm'n*, 221 F.3d 928 (7th Cir. 2000).
[90] *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 45 (1984) ("the proper focus is on the structure of the market for the products or services in question – the number of sellers and buyers in the market, the volume of their business, and the ease with which buyers and sellers can redirect their purchases or sales to others. Exclusive dealing is an unreasonable restraint on trade only when a significant fraction of buyers or sellers are frozen out of a market by the exclusive dealing").
[91] See, e.g., *Fashion Originators Guild v. FTC*, 312 U.S. 457 (1941) (the Supreme Court upheld an FTC cease and desist order against the Fashion Guild. The member manufacturers had organized a boycott of retailers that they found to be selling copied items).
[92] See, e.g., *In re Microsoft Corp.*, 309 F.3d 193 (4th Cir. 2002).

finding that Toys "R" Us acted as a hub for a conspiracy between Toys "R" Us and leading toy manufacturers.[93] FTC found that the manufacturers and Toys "R" Us conspired to restrict sales to discount toy stores.[94]

Manufacturers also need to be conscious of the risks involved in so-called dual distribution arrangements. Dual distribution refers to a situation where a manufacturer sells both to retailers and also directly to consumers – i.e., where the manufacturer has integrated downstream into its own retail operations. In such a situation, a manufacturer is competing with the retailers as well as cooperating with them; thus, the arrangement could be characterized as horizontal. For example, in a dual distribution arrangement, an RPM policy imposed by a manufacturer could arguably be interpreted as a *per se* illegal horizontal price fixing agreement between retailers. Most courts, however, have characterized dual distribution arrangements as vertical and applied the rule of reason.[95] Nevertheless, because the Supreme Court has never ruled on this, manufacturers that also sell directly to consumers should be cautious and consult with counsel when implementing restraints that may pose antitrust issues.

F. Issues with Internet Sales

Restraints on internet sales are generally analyzed in the same manner as vertical restrictions on brick and mortar retailers. [96] As with traditional retailers, non-price vertical restraints on internet distribution are analyzed under the rule of reason. Likewise, online RPM polices are analyzed under the rule of reason under federal law, but may be analyzed as *per se* violations under certain state antitrust laws.

Although internet sales are largely analyzed under traditional antitrust theories, internet distribution does raise some novel issues. For example, the implementation of MAP policies on the internet is often much different than in traditional brick and mortar stores. MAP policies on the internet can take a variety of forms, with some more transparent to consumers than others. On one end of the spectrum are polices that permit an online retailer to advertise a lower price only when a customer places a product into his or her online shopping basket and clicks through to view it. On the other end of the spectrum are policies that prohibit an online retailer from advertising a lower price anywhere on the internet, but may invite consumers to call or email the company for a lower price. As with traditional MAP policies, the closer an online MAP policy is to an RPM policy, the

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[93] Toys *"R" Us v. FTC*, 221 F.3d 928 (7th Cir. 2000).

[94] Hub and spoke issues may also arise where a retailer enters into a series of most favored nation (MFN) agreements with suppliers.

[95] See *Spahr v. Leegin Creative Leather Prods., Inc.*, 2008 WL 3914461, **6-7 (E.D.Tenn. 2008) (the court rejected a claim that the manufacturer's dual distribution system transformed its RPM policy into a *per se* unlawful horizontal price-fixing scheme); *PSKS, Inc. v. Leegin Creative Leather Products*, 615 F.3d 412, 420-21 (5th Cir. 2010); *AT&T Corp. v. JMC Telecom*, 470 F.3d 525, 531 (3d Cir. 2006); *Jacobs v. Tempur-Pedic Int'l*, 626 F.3d 1327 (11th Cir. 2010) (finding that the recent trend has been "to view the primary relationship between a dual distributor and an independent franchisee as vertical where the restrictions do not lessen interbrand competition or decrease the availability of goods or services").

[96] See, e.g., *Coffee.org, Inc v. Green Mountain Coffee Roasters, Inc.*, 2012 U.S. Dist. LEXIS 18577 (W.D. Ark. 15 February 2012) (rejecting a monopolization claim where a manufacturer refused to distribute through an online seller that did not have "brick and mortar" presence); *MD Products, Inc. v. Callaway Golf Sales Co.*, 459 F. Supp. 2d 434 (W.D.N.C. 2006) (the court relied on traditional antitrust analysis to find that a manufacturer's restrictions on internet sales were unilateral and thus not unlawful under the antitrust laws); *Worldhomecenter, Inc., v. L.D. Kichler Co.*, 2007 U.S. Dist Lexis 22496 (E.D.N.Y. 28 March 2007) (the court relied on traditional antitrust methods to assess minimum advertising policies on the internet).

more antitrust risk arises. The risk that an internet MAP policy might be characterized as an RPM policy is somewhat greater than with a brick and mortar store; however, because, unlike face-to-face dealing, there is little ability on retailer internet websites to negotiate prices, the price advertised is generally the price paid.

In *Worldhomecenter.com, Inc. v. Franke Consumer Products, Inc.*, a U.S. District Judge for the Southern District of New York held that an online MAP policy implemented by kitchen products company Franke Consumer Products was not an unlawful RPM policy.[97] The policy prohibited online retailers from publishing prices below a specified range and allowed Franke to terminate those retailers who did not comply. Importantly, however, the policy also allowed retailers to notify consumers that they were free to call or email Franke to obtain the retailer's lowest price. Worldhomecenter.com, an internet retailer, violated Franke's MAP policy and was terminated. Worldhomecenter.com sued, claiming that the policy was a *per se* illegal RPM policy under New York law. The court disagreed and found the policy lawful, noting that it provided avenues for the retailer to advertise lower prices and was thus not an RPM policy. Similarly, in *Worldhomecenter.com v. KWC America*, a U.S. District Court in the Southern District of New York dismissed an antitrust suit against kitchen supply company KWC America accusing it of having an illegal MAP policy. In dismissing the claim, the court noted that the policy provided that "actual prices charged to customers may be provided by telephone, email response, and product purchase confirmation webpages or communications." [98] Thus, the court found that the policy was not akin to an RPM policy. In contrast, four years earlier, in a case brought by the same online retailer, a U.S. District Judge for the Eastern District of New York denied a motion to dismiss antitrust claims accusing L.D. Kichler, a lighting manufacturer, of implementing an illegal online MAP agreement.[99] The court held that, taking Worldhomecenter.com's allegations as true, "essentially, the advertised price is the retail price for an internet shopper". Thus, the MAP policy "[had] the concomitant effect of restricting retail prices for internet retailers." The court, however, provided little detail in its opinion to guide future companies in implementing MAP policies on the web.

Chile

A. The Framework of Competition Law in Chile

Chile does not have specific laws that address the competition aspects of distribution agreements and the vertical restraints included in such agreements. These matters fall under the general Chilean Antitrust Law, contained in Decree Law Nr. 211 of 1973 (DL 211). Moreover, vertical restraints entered into by companies that do not hold a dominant position[100] fall outside the scope of the Chilean antitrust rules altogether. Vertical restraints entered into by dominant companies are assessed under the rules on abuse of dominance, which are contained in article 3b) of DL 211. In Chile, there are two authorities with jurisdiction to enforce antitrust law, including in relation to agreements containing vertical restraints, the Chilean National Economic

[97] *Worldhomecenter.com, Inc. v. Franke Consumer Products, Inc.*, No. 10 Civ. 3205 (S.D.N.Y. 22 June 2011).
[98] *Worldhomecenter.com, Inc. v. KWC America, Inc.*, 2011 WL 4352390 (S.D.N.Y. 15 September 2011).
[99] *Worldhomecenter.com Inc. v. L.D. Kichler Co.*, 2007 WL 963206 (E.D.N.Y. 28 March 2007).
[100] It is worth noting that, under the Chilean competition rules, there is no market share threshold above which dominance is presumed.

Prosecutor's office (***FNE***) and the Antitrust Court (*Tribunal de Defensa de la Libre Competencia*).

The FNE has issued internal guidelines regarding vertical restraints, which shed light as to when they may be considered by the authorities as a breach of antitrust regulation. It is worth noting that these guidelines are not legally enforceable and are non-binding for the market, but provide a useful overview of the criteria applied by the Chilean antitrust authorities when assessing vertical restraints.

1. Recent Enforcement Trends

The Chilean antitrust authorities have not been particularly active in enforcing antitrust law in the luxury goods and fashion industry so far. The most significant example of a judicial case concerning the industry in the last few years is the legal action taken against a cartel formed by a group of travel agencies active in the luxury hotels industry, which ended in 2012.[101]

With respect to distribution and vertical agreements more generally, the main enforcement focus has been on dominant companies that imposed vertical restraints with the aim of foreclosing competitors: e.g., by restricting distributors from selling other brands of the same product (e.g., in the cigarette or matches industries), or by establishing rebates for sales volume, with the aim of excluding competitors (e.g., in the fabric and house cleaning industry).

B. Pricing Issues

1. Fixing the Resale Price/Retailer Margin

Although Chilean antitrust law does not expressly prohibit resale price restrictions such as RPM, and the Chilean authorities have not been particularly active in this area, there nonetheless appears to be consensus among practitioners, and supported by the Chilean authorities, that the imposition of fixed prices by a producer/seller on a distributor/retailer constitutes a breach of Chilean antitrust law, more specifically of article 3b) of DL 211, assuming both of the following conditions are met:

i. that the restriction is imposed by a producer/seller that has a dominant position in the corresponding market; and
ii. that the restriction impedes, limits or hinders competition, or has the capacity of producing such a result, and that such damage to competition is not "countered" or "justified" by any efficiencies that the same may produce.

2. Maximum Prices

Maximum prices imposed by a producer on a distributor/retailer are generally not considered to constitute a breach of Chilean antitrust law (on the basis that setting a maximum limit on prices usually produces benefits for consumers). However, in application of general antitrust principles, the imposition of maximum prices may be considered illegal if they are imposed with the aim of

[101] FNE against Abercrombie & Kent S.A. and others, Sentence Nr. 113 of the Antitrust Court dated 19 October 2011, sentence by the Supreme Court dated 20 September 2012,

influencing competition (e.g., if imposed by a dominant seller with the aim of controlling or eliminating competition at the distribution level).

3. Recommended Prices

The recommendation of prices by a producer to a distributor/retailer is not considered illegal under Chilean law. However, if such recommendations are in some way "enforced" or "induced" by the seller, then such price recommendations may be considered unlawful, as they may have the same effect as an RPM clause

4. Minimum Advertised Price

Under Chilean consumer protection regulations, it is illegal for a retailer to advertise a product to the general public at a price different than that at which it is actually sold. Therefore, advertised prices of a product are generally equal to its actual selling price (otherwise, the retailer would be in breach of applicable consumer protection regulations). In light of this, MAPs are not normally used in Chile. However, if such restrictions were agreed in practice, they would likely be treated in the same way as fixed minimum resale prices restrictions.

C. Vertical Non-price Restraints

Vertical non-price restraints, such as territorial or customers restrictions, have generally not been the focus of antitrust authorities in the past years. They are not expressly referred to as an example of anti-competitive conduct in the Chilean antirust law, although vertical non-price restraints may nonetheless be considered in breach of the Chilean antitrust law under the general Chilean antitrust rules. For this to be the case, all the general conditions for an unlawful abuse of dominance have to be met: i.e., that the restriction is imposed with the aim of affecting competition, that the same is imposed by a dominant seller, that the same does not have any positive economic effects (e.g., synergies or other), etc. The same would be true regardless of the industry in which the relevant undertakings imposing such vertical non-price restraints are active. However, there are no precedents for this, whether in the fashion and luxury goods sector or other markets.

D. Horizontal Restraints

Horizontal restraints, i.e., agreements between competitors with the aim of affecting competition – e.g. by fixing prices, sharing competitively sensitive information, allocating customers or territories – are generally considered to infringe Chilean competition law, in accordance with article 3a) of DL 211, which governs anti-competitive agreements. This is the case regardless of the industry that the anti-competitive agreement pertains to.

It should be noted that illegal horizontal restraints may exist both where competitors exchange relevant information directly and where they do so indirectly through a third party in a hub and spoke arrangement. There are a number of recent hub and spoke cases in Chile (e.g., the retail pharmacies cartel of 2008-2009, in which the Antitrust Court alleged that the retailers exchanged information through laboratories supplying competing pharmacies).[102]

E. Internet Sales

The issue of restrictions on internet sales has not attracted any real attention from the antitrust authorities in Chile (in fact, there are no special laws or soft laws that apply to online sales). However, consumer protection laws stipulate that internet sales should be regarded and treated in the same way as store sales (with the same protections available to consumers), and, therefore, from an antitrust point of view, it is arguable that the principles and criteria applicable to internet sales should not be any different from those applicable to sales via bricks and mortar stores.

Colombia

A. Framework of Competition Law

1. The Rules Applicable to Distribution Agreements

Colombian laws and regulations regarding the issues of competition, antitrust and pricing are all based on article 333 of the Colombian Constitution, pursuant to which free competition is a right of all Colombian citizens and residents.

Law 155 of 1959 sets out that any action the purpose or effect of which is the restriction of free competition or the maintenance or determination of unfair prices shall be illegal and thus null and void under Colombian regulations. In addition to Law 155 of 1959, Decree 2153 of 1992 sets out the actions and agreements that are considered practices in restraint of trade in Colombia.

Restrictive agreements are defined by Colombian laws as any agreement or arrangement that directly or indirectly has the purpose or effect of limiting activities such as the production, supply, distribution or consumption of foreign or national raw materials, products, merchandise or services; and all kinds of practices, procedures and systems that tend to restrict free competition and/or maintain or fix prices. Such agreements or arrangements are prohibited and will be considered null and void.

Colombia's antitrust legislation, as a general rule, makes no distinction between horizontal and vertical restraints. Furthermore, the illegality is analyzed from the intent and effects perspectives. Additionally, the law does not explicitly spell out the criteria for illegality *per se* and the rule of reason. Therefore, certain covenants that may be lawful and frequently used in other jurisdictions, should be analyzed carefully when structuring distribution relationships in Colombia.

The Superintendence of Industry and Commerce (SIC), the Competition Regulator in Colombia, has adopted a very strict approach with respect to the interpretation and validity of non-compete clauses (even where agreed as ancillary obligations in the acquisition of assets or shares).

[102] FNE against Farmacias Ahumada S.A. and others, Sentence Nr. 119 of the Antitrust Court dated 31 January 2012, sentence by the Supreme Court dated 7 September 2012.

Non-compete covenants effective after the termination of a distribution agreement will be deemed to be null and void and restrictive of trade.[103]

B. Pricing Issues

1. Fixing the Resale Price/Retailer Margin

SIC has established that this prohibition is applicable to parties in separate links of a given distribution chain (i.e., wholesaler, distributor and retailer) who must establish their own independent pricing formulae.[104] Accordingly, the resale price maintenance prohibition is not applicable whenever there is no separate link but the existence of a representative (i.e., agent and broker) of the business charging the prices in the first place. If the principal is independent of the distributor (which assumes the risk and property over the goods and obtains its profit from the difference between cost of purchase and selling price), it cannot be forced to follow a predetermined price set by the publisher.

2. Maximum Prices

Any provision or arrangement that is intended (or has the effect of) creating the obligation on independent distributors to follow resale price impositions from the principal, is prohibited, in accordance with SIC's interpretation of the provision that prohibits agreements to set prices.[105] Under SIC's current position, RPM, even when it is intended to set maximum prices, is considered to be illegal *per se*.

3. Recommended Prices

Price suggestions are permitted as long as the principal adopts no retaliation against the distributor when such a suggestion is disregarded. Retaliation for non-compliance with a suggested price is considered an antitrust violation, which may be subject to fines.

C. Vertical Non-price Restraints

According to the applicable laws in Colombia, any agreement that directly or indirectly has the purpose of limiting the distribution or consumption of products will be considered illegal. [106] Furthermore, any agreement between manufacturers or distributors that has the purpose or effect of partitioning a market is also illegal.[107]

Notwithstanding the above, SIC has considered that such provisions should be interpreted in conjunction with the laws regarding exclusive distributorship structures, and has suggested in at

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[103] In Ruling 46325 of August 2010, the SICe expressly said that: "...*any clause or agreement disallowing a merchant to compete may be considered, in abstract, a restriction to competition, because, even though seller transferred a number of assets, it would always have the possibility of beginning a new business, which would ultimately favor the consumer (which would have an additional source of offer)*".

[104] Superintendence of Industry and Commerce; Opinion No. 99041220-02 of 1999.

[105] Decree 2153 of 1992, article 47(1).

[106] Article 1, Law 155, 1959 and article 7b, Decision 608 from the Andean Community.

[107] Article 47.3, Decree 2153, 1992 and article 7c, Decision 608 from the Andean Community.

least one case that territorial allocation in vertical distribution schemes should be analyzed under a rule of reason.

In this regard, SIC has considered in at least one case[108] that the territorial allocation in vertical relationships can be considered to be legal if the efficiencies of the territorial restrictions can be demonstrated. In a different opinion,[109] SIC established that, even where there are efficiencies to vertical territorial allocations (via exclusive territorial arrangements), it is necessary that the agreements define that in no case can the distributor be prevented from selling products to customers that are out of the territory assigned to such distributor. SIC's opinion thus suggests that active sales out of the designated territory may be prevented but that in no case can the vertical arrangement prevent the seller or distributor from selling to a customer from out of the territory that requests such sale.

a. Territorial Allocation

Geographic allocation between the principal and its distributors is permitted under Colombian antitrust regulations.[110] However, the principal is not allowed to restrict the distributor from making passive sales within its territory. This means that the distributor can be prevented from actively pursuing clients outside of its territory but cannot be prevented from selling products to a customer of a territory not assigned to it, if the customer goes to the distributor's territory. The same rule will apply with respect to client allocations.

b. Non-compete Covenants

Non-compete clauses are valid when reasonable circumstances arise. In general, a non-compete obligation during the term of the agreement will be enforceable in Colombia, as long as it is limited to the same or similar products and limited to the territory described within the distribution agreement. It will be deemed an exclusivity clause. Exclusivity clauses, however, should also be analyzed on a case-by-case basis because, in some circumstances, they could be deemed to be unlawful (e.g., when the exclusivity clause has the purpose or effect of foreclosing the market).

D. Horizontal Restraints

Article 47 of Decree 2153 lists the following activities and/or agreements as examples of restrictive agreements:

i. Price fixing: i.e., any action or agreement between two or more competitors, the purpose or effect of which is to directly or indirectly fix the price of products or services. Hence, any agreement or concerted practice between two or more distributors, the purpose or effect of which is to establish or determine the prices of goods or services in Colombia, will be caught by this prohibition.

ii. Exchanges of information between competitors might, in certain cases, raise concerns. For instance, acquiring market studies or accessing information that is not aggregated,

[108] Resolution 1382 of 1995.
[109] Opinion 96062308 of 1996.
[110] Namely, Law 155 of 1959, Law 1340 of 2009, Decree 2153 of 1992.

and allows identification of competitors, their brands and, in many cases, the specific products commercialized by each competitor, and that includes references to their revenues and volumes (by brand and by product), may trigger competition concerns.

iii. Creation of discriminatory conditions for sales or trade: i.e., actions or agreements, the purpose or effect of which is the creation of discriminatory sales or trading conditions for third parties.
Thus, any special treatment given to a supplier or a distributor should be on an objective basis, which implies that any market agent that meets the same conditions as that to which the special treatment is given should receive the same treatment. Unjustified discrimination against a sub distributor is illegal.
Hence, any concerted actions the intention or effect of which is blocking the sale of products to a distributor (because, for instance, it is selling products at a lower price or to clients out of an assigned territory) may be considered illegal under Colombian antitrust regulations.

iv. Market partition or allocation of territories or clientele.
This means any action or agreement between two or more parties, the purpose or effect of which is to divide certain markets. Sanctions for splitting the market in horizontal agreements will be penalized more severely than in vertical relationships.

Mexico

A. The Framework of Competition Law in Mexico

1. The Rules Applicable to Distribution Agreements

The Mexican Competition Law (MCL) applies to two different kinds of practices that can be deemed anti-competitive: so-called *absolute* monopolistic practices (horizontal agreements)[111] and so-called *relative* monopolistic practices (vertical agreements).[112] Monopolistic practices are those performed by an economic agent with substantial market power.[113] Restrictions in distribution agreements can be considered as both absolute and relative monopolistic practices, and therefore fall under the relevant rules applicable to both kinds of monopolistic practices in Mexico.

Under the MCL, any contract, agreement, arrangement or combination between competing economic undertakings is considered to be anti-competitive and an absolute monopolistic practice in breach of the MCL, where the purpose or effect of such contract, agreement, arrangement or combination is any of the following:

i. price fixing;
ii. restriction of output;
iii. market segmentation;
iv. bid rigging; or

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[111] Absolute monopolistic practices are regulated by article 53 of the MCL.
[112] Relative monopolistic practices are regulated by articles 54 to 56 of the MCL.
[113] Substantial market power can be defined as the capacity to fix prices, or substantially restrict the supply or provision to the relevant market, without competing agents being actually or potentially capable of counteracting such capacity. Under the MCL, there is no market-share threshold above which a company is presumed to be dominant. The analysis to assess whether or not an economic agent has substantial market power must be made on a case-by-case basis.

v. exchange of information resulting in any of the above.

Agreements containing these kinds of restrictions/provisions are automatically null and void.

Separately, *relative* monopolistic practices are those acts, contracts, agreements, procedures or combinations the purpose or effect of which is, or might be, to unduly displace other agents from, or substantially preclude their access to, a market. These practices are:

i. vertical price fixing;
ii. resale price maintenance;
iii. tying;
iv. exclusive dealing;
v. refusals to deal;
vi. boycotts;
vii. predatory pricing;
viii. loyalty rebates;
ix. cross subsidies;
x. price discrimination;
xi. raising third parties' costs;
xii. denying access to essential facilities (or granting access on discriminatory terms only); or
xiii. margin squeeze.

However, these types of practices are not illegal *per se* but are subject to a rule of reason assessment. In order for these practices to be illegal, it has to be shown that their object or effect was to unduly displace other undertakings from, or substantially preclude their access to, a market.

In addition, even if the conditions referred to in the above paragraph are met, a relative monopolistic practice can nonetheless be permitted under the MCL if efficiency gains are generated, so that the net contribution to consumers' welfare outweighs any anti-competitive effects resulting from the alleged practice.

The MCL does not set forth specific regulations regarding distribution agreements. As such, distribution agreements are subject to the general rules of the MCL.

2. Recent Enforcement Trends

We are not aware of any recent enforcement action in the luxury goods and fashion industry and/or in relation to distribution agreements. However, it is worth noting that competition enforcement in Mexico has recently been strengthened, with the revised MCL having come into force on 17 June 2014. In particular, the revised MCL grants the Mexican Competition Commission (*Cofece*) broader powers to investigate anti-competitive conduct than was the case under the previous legislation. For example, Cofece now has the power to arrest individuals that fail to cooperate during an investigation; there are new rules governing dawn raids, granting Cofece wide powers to seize documents; and Cofece now has the power to request additional explanations regarding such seized documents from any company officer or representative.

B. Pricing Issues

1. Fixing the Resale Price/Retailer Margin

Fixing the resale price or retailer margin is considered a relative monopolistic practice under the MCL, and, as such, is not illegal *per se*, but only in the case that (i) the supplier can be considered to have substantial market power; and (ii) the conduct has a negative effect on the market. Additionally, even if (i) and (ii) are met, if it can be demonstrated that the efficiency gains resulting from the alleged conduct outweigh any negative effect on competition, such conduct may nonetheless be considered not to infringe the MCL.

2. Maximum Prices

The provisions in the MCL applying to relative monopolistic practices in relation to prices cover not only the fixing of resale prices, but any other conditions that distributors must observe while commercializing or distributing products (i.e., minimum or maximum resale prices, obligatory discounts or rebates, including operating hours). For such practices to be considered an infringement of the MCL, the same aforementioned conditions apply (i.e., that such practices must be carried out by a company with market power, and that any negative effect on competition resulting from these practices is not outweighed by any efficiency gains resulting from such practices).

3. Recommended Prices

Recommended prices do not usually give rise to concerns under the MCL, provided the distributors are entirely free to set final prices for their customers.

4. Minimum Advertised Price

So-called MAP clauses are permitted under the MCL, provided they do not result in price fixing – distributors must remain free to set final prices for their customers.

C. Vertical Non-price Restraints

All vertical non-price restraints of competition, including territorial, customer and/or channel restrictions, as well as exclusive and selective distribution models, are considered relative monopolistic practices under the MCL and are subject to a rule of reason assessment.

Furthermore, as indicated above, these practices are not illegal *per se*, but only when performed by an economic agent with substantial market power, and provided the object or effect of the conduct is to unduly displace other agents from, or substantially preclude their access to, the market. As with any other relative monopolistic practice, such practices may nonetheless not fall foul of the MCL, where efficiency gains can be shown that outweigh any negative effect on competition resulting from the alleged practices.

D. Horizontal Restraints

As indicated in point 1 above, the following horizontal restraints are considered absolute monopolistic practices and are therefore illegal *per se*: price fixing, restricting output, market segmentation, bid rigging and exchange of competitively sensitive information. Although hub and spoke type agreements are not expressly covered by the MCL, such arrangements may nonetheless give rise to a breach of the MCL; in particular, where such arrangements facilitate collusion between competing distributors.

We are not aware of any recent enforcement action in the luxury goods and fashion industry and/or in relation to horizontal restraints. However, as mentioned above, competition enforcement has been strengthened generally, with the broader investigative powers granted to Cofece under the revised MCL, and we may therefore see more enforcement action by Cofece in this sector in the future.

E. Issues with Internet Sales

The MCL does not include specific provisions governing e-commerce/sales over the internet. Thus, the general provisions on monopolistic practices apply. In any event, e-commerce has not been a particular focus for Cofece, and we are not aware of recent enforcement action in this area.

In general, the main issues concerning competition rules governing e-commerce will be to ensure that the chosen distribution model is appropriately dealt with in contracts with dealers. Any restrictive arrangements in such contracts may raise competition law concerns. Where such arrangements involve an element of selective distribution, care needs to be taken to ensure dealers are treated fairly and consistently, to avoid any concerns relating to the MCL. Any restrictions on internet sales should also be considered carefully; in particular, with regards to how such restrictions are structured. Clear criteria and communication with dealers, as well as careful management to ensure consistent application, are essential to minimize the risk of infringing the MCL.

IV. Asia Pacific

Australia

A. The Framework of Competition Law in Australia

1. The Rules Applicable to Distribution Agreements

Australia has no specific laws regulating distribution agreements. They are subject to the general rules against anti-competitive conduct in the *Competition and Consumer Act 2010* (Cth) (CCA), the main statute dealing with competition law in Australia.

Part IV of the CCA sets out the prohibitions against anti-competitive conduct. It contains two types of prohibitions: “*per se*” or absolute prohibitions, which prohibit certain conduct irrespective of its effect on competition; and prohibitions that are dependent on the conduct having the purpose or likely effect of substantially lessening competition (the so-called “competition test”). The types of conduct that are absolutely prohibited are:

i. cartel conduct, price fixing, and exclusionary provisions/collective boycotts;
ii. third line forcing (this refers to the situation where two parties enter into a type of exclusive dealing arrangement on the condition that the purchaser buys the relevant goods and/or services from a particular third party, or where a party refuses to supply because the purchaser will not agree to such a condition);
iii. resale price maintenance; and
iv. misuse of market power (including predatory pricing).

The types of conduct that are subject to the competition test are:

i. anti-competitive contracts, arrangements and understandings;
ii. exclusive dealing arrangements (other than third line forcing); and
iii. secondary boycotts (this refers to situations where one person, together with a second person, engages in conduct that hinders or prevents a third-party supplier from supplying goods and services, or prevents customers from buying goods or services from a third-party supplier, where such conduct will, or is likely to, cause substantial loss or damage to the business of the third-party supplier).

2. Recent Enforcement Trends

The CCA is administered and enforced by the Australian Competition and Consumer Commission (ACCC). ACCC has extensive powers to investigate anti-competitive conduct, and is a proactive and effective regulator. While cartel conduct is a priority for ACCC, it does actively investigate anti-competitive conduct involving distribution arrangements. Recent ACCC enforcement activity involving distribution arrangements has focused on resale price maintenance (see section (b) below), as well as cartel conduct issues in relation to dual distribution arrangements.

There have been only a few competition cases involving the luxury goods and fashion industries in recent years, and they have mostly focused on RPM.[114]

B. Pricing Issues

1. Fixing the Resale Price/Retailer Margin

Suppliers of goods or services in Australia are prohibited from specifying a minimum resale price, and may not withhold supply on the basis that the reseller has refused to comply with a specified minimum resale price.

Resale price maintenance is defined broadly in Australia, and extends to inducing or attempting to induce a supplier not to sell or advertise below a minimum resale price. Further, “withholding supply” for the purpose of the prohibition against resale price maintenance includes refusing to supply except on disadvantageous or less favorable terms.

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[114] However, it is worth noting that, outside the area of competition law, ACCC has been very active in recent years in relation to enforcing consumer protection legislation and has brought a number of proceedings against companies in the luxury goods industry.

Recent enforcement action for resale price maintenance against companies supplying luxury or premium goods includes:

i. a supplier of household electrical goods was fined A$2.2 million when it was found to have engaged in resale price maintenance when it attempted to induce a dealer not to sell its air conditioning products below a certain price, and subsequently withheld the supply of goods to the dealer (by reducing the level of discount provided to the dealer);[115]
ii. an Australian cosmetics company was fined A$3.2 million (and a fine of A$200,000 was imposed against its managing director) for engaging in resale price maintenance over an extended period of time, as well as for engaging in price fixing conduct with a number of its franchisees; and[116]
iii. a supplier of GPS devices was fined A$1.25 million, and fines of A$80,000 and A$30000 respectively were imposed on a former director and sales manager, for resale price maintenance conduct, which included seeking to prevent internet resellers from discounting its products.[117]

In addition, smaller penalties have also been imposed against a number of companies for resale price maintenance, including a penalty of A$90,000 against a supplier of skin care products for engaging in resale price maintenance, by inducing or attempting to induce two retailers not to sell products online at prices less than those specified by the supplier;[118] and a penalty of A$134,000 against a supplier of sportswear for engaging in resale price maintenance, by inducing or attempting to induce retailers not to advertise their products at prices less than the recommended retail price.[119]

2. Maximum Prices

It is permissible for a supplier to specify a maximum resale price, provided that it is a genuine maximum and does not amount to a de facto actual price at which the reseller must resell the goods. The reseller must be free to sell below the maximum resale price.

3. Recommended Prices

It is permissible for a supplier to issue a recommended resale price, provided that the price is a recommendation only and there is no obligation to comply with the recommended resale price. This should be made clear at the time the recommended price is provided.

4. Minimum Advertised Price

The prohibition against resale price maintenance in Australia also extends to advertised prices. Accordingly, suppliers are prohibited from specifying a MAP.

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115 http://www.austlii.edu.au/au/cases/cth/FCA/2013/1413.html
116 http://www.austlii.edu.au/au/cases/cth/FCA/2007/79.html
117 http://www.austlii.edu.au/au/cases/cth/FCA/2007/2061.html
118 http://www.austlii.edu.au/au/cases/cth/FCA/2012/1124.html
119 http://www.austlii.edu.au/au/cases/cth/FCA/2009/710.html

C. Vertical Non-price Restraints

In Australia, vertical restraints (such as prohibitions on distributors selling outside a particular territory or selling to particular customers, and non-compete/single branding clauses), and point of sale or sales channel restrictions, are generally lawful, unless they:

i. have the purpose, effect or likely effect of substantially lessening competition in a market in Australia; or
ii. constitute a misuse of market power.

Section 47 of the CCA prohibits exclusive dealing restrictions if they have the purpose, effect or likely effect of substantially lessening competition in a relevant market. In addition, there is a general prohibition against contracts, arrangements or understandings that have the purpose, effect or likely effect of substantially lessening competition in a market.

Section 46 of the CCA prohibits a corporation with a substantial degree of power[120] from taking advantage of that power for the purpose of eliminating or damaging a competitor, preventing market entry, or deterring or preventing a person engaging in competitive conduct.

If the supplier competes in downstream markets with its distributors, then vertical non-price restraints can also potentially constitute cartel provisions in breach of the CCA. In such cases, care needs to be taken to ensure that the restrictions do not breach the *per se* prohibitions against cartel conduct.

Vertical non-price restrictions are actively investigated by ACCC, although there has not been any recent enforcement action concerning non-price vertical restraints in the fashion or luxury goods industry. The last significant penalty imposed for non-price vertical restrictions was in the life sciences industry, in 2010, where a A$4.9 million penalty was imposed on a major pharmaceutical company for conduct that involved bundling and exclusivity restrictions on the supply of its products.[121] This conduct was found to constitute unlawful exclusive dealing and a misuse of market power.

D. Horizontal Restraints

In Australia, the prohibitions in relation to horizontal restraints are the prohibitions in the CCA against cartel conduct and exclusionary provisions. The CCA lists parallel criminal and civil offenses against competitors making or giving effect to a contract, arrangement or understanding that contains a "cartel provision". A "cartel provision" is a provision of a contract, arrangement or understanding that has:

i. the purpose or effect, or likely effect, of fixing, controlling or maintaining prices;
ii. the purpose of restricting outputs in the production or supply chain;
iii. the purpose of allocating customers, suppliers or territories; and/or
iv. the purpose of rigging bids or tenders.

The CCA also contains a *per se* prohibition against exclusionary provisions (or "collective boycotts"), which are provisions of a contract, arrangement or understanding between competitors that have the purpose of preventing, restricting or limiting the supply of goods or services to a

[120] The threshold for establishing substantial market power is lower than for establishing dominance.
[121] http://www.austlii.edu.au/au/cases/cth/FCAFC/2008/141.html (Full Federal Court decision on sections 46 and 47); http://www.austlii.edu.au/au/cases/cth/FCA/2010/929.html (penalty judgment).

particular person or group, or have the purpose of preventing, restricting or limiting the acquisition of goods or services from a particular person or group.

While there are specific prohibitions against price signaling in Australia, these currently only apply to the banking industry. Accordingly, the mere exchange of information by competitors is not of itself likely to breach the CCA. An exchange of information between competitors is prohibited only if it has the purpose, effect or likely effect of substantially lessening competition.

Cartel conduct is an ongoing enforcement priority for ACCC, and it will actively investigate and prosecute cartel conduct. ACCC's enforcement activity against cartel conduct is supported by an effective immunity policy. While, with the exception of the cosmetics case referred to above, there have been no recent enforcement cases involving companies in the luxury goods industry, ACCC is very active in prosecuting cartel conduct. Recent enforcement cases include:

i. penalties of A$11 million were imposed against a travel agent for attempting to fix prices with two of its airline principals in relation to online sales of airfares;[122]
ii. total penalties of A$98.5 million were imposed on a number of airlines for price fixing surcharges for air cargo, including a penalty of A$20 million against Qantas[123]; and
iii. total penalties of A$8.3 million were imposed against two suppliers of forklift gas, and three former senior managers of those suppliers, for price fixing and market sharing – in addition, a three-year disqualification order was imposed on one manager, barring that individual from managing a corporation for that period.[124]

E. Issues with Internet Sales

Australia has no specific competition laws regulating e-commerce. The prohibitions contained in Part IV of the CCA apply to internet sales. Accordingly, a restriction preventing a reseller from making internet sales will contravene the CCA if it:

i. constitutes a misuse of market power; or
ii. has the purpose, effect or likely effect of substantially lessening competition in a market in Australia.

ACCC has recently identified the online marketplace as an enforcement priority and there have been a number of recent cases involving online sales. ACCC obtained penalties of A$2.5 million against a ticketing agency for taking advantage of its market power to deter or prevent a newly established online competitor from supplying its services, by refusing to grant a competing ticket supplier access to discounts in its ticketing system.[125] As noted above, ACCC has also taken enforcement action for resale price maintenance conduct where a supplier has sought to restrict online retailers from selling goods below a specified price.

[122] http://www.austlii.edu.au/au/cases/cth/FCA/2013/1313.html (judgment on liability); http://www.austlii.edu.au/au/cases/cth/FCA/2014/292.html (judgment on penalty).
[123] http://www.austlii.edu.au/au/cases/cth/FCA/2008/1976.html
[124] http://www.austlii.edu.au/au/cases/cth/FCA/2014/1135.html
[125] http://www.austlii.edu.au/au/cases/cth/FCA/2011/1489.html

China

A. The Framework of Competition Law in China

1. The Rules Applicable to Distribution Agreements

The main antitrust regulation in the People's Republic of China is the Anti-Monopoly Law of China (Anti-Monopoly Law), which came into effect on 1 August 2008. The Anti-Monopoly Law prohibits monopolistic conduct, which is defined as any of the following activities: (a) anti-competitive agreements; (b) the abuse of a dominant market position; or (c) mergers and acquisitions that may have the effect of eliminating or restricting competition. This section focuses on the rules relating to anti-competitive agreements and the abuse of a dominant market position.

In addition to the Anti-Monopoly Law itself, various implementing rules and guidelines exist that assist in the application and interpretation of the Anti-Monopoly Law.

Anti-competitive Agreements

Anti-competitive agreements (referred to as "monopoly agreements" under the Anti-Monopoly Law) are defined as agreements, decisions or concerted practices between business operators that restrict or eliminate competition.[126] The following horizontal agreements are considered to be anti-competitive and are prohibited:[127]

i. agreements to fix or change the price of goods;
ii. agreements to restrict the quantity of goods produced or sold;
iii. agreements to divide a sales market or a raw materials procurement market;
iv. agreements to restrict the purchase of new technology or new equipment, or to restrict the development of new technology or new products; and
v. concerted refusals to deal.

The following vertical agreements are considered to be anti-competitive and are prohibited:[128]

i. fixing the prices at which goods are resold to third parties; and
ii. setting a minimum price for the resale of goods to third parties.

The lists of horizontal and vertical agreements above are non-exhaustive, and additional types of anti-competitive agreements may be added by China's competition authorities at any time.

An exemption from the prohibition on horizontal and vertical agreements is available, if the business operator can demonstrate that:[129]

i. the agreement will not substantially restrict competition in the relevant market;
ii. consumers will receive a fair share of the resulting benefits; and
iii. the agreement has a qualifying purpose, such as technological advancement and/or product development, improvement in product quality, increases in efficiency and reduction in costs.

[126] Article 13 of the Anti-Monopoly Law.
[127] Article 13 of the Anti-Monopoly Law.
[128] Article 14 of the Anti-Monopoly Law.
[129] Article 15 of the Anti-Monopoly Law.

Abuse of a Dominant Market Position

A dominant market position is defined as the ability of one or several business operators to control the price, volume or other trading terms in the relevant market, or to otherwise affect conditions of a transaction, so as to hinder or influence the ability of other business operators to enter the market.[130]

The dominance assessment is based on a number of factors, including the relevant business operator's market shares, the ability of the business operator to control the sale or input market, the financial and technical resources of the business operator, competitiveness of the relevant market, the extent to which other business operators rely on the relevant business operator, and barriers to market entry.[131]

A dominant market position is presumed where a business operator's market share exceeds 50 percent. Moreover, a dominant market position is presumed where a business operator's market share is 10 percent or greater and:[132]

i. the combined market share of the business operator and one other business operator exceeds 66.6 percent; or
ii. the combined market share of the business operator and two other business operators exceeds 75 percent.

A business operator can rebut the presumption of dominance by providing evidence to the contrary.

Under the Anti-Monopoly Law, a business operator with a dominant market position is prohibited from carrying out any of the following types of conduct as an abuse of a dominant market position:[133]

i. selling goods at prices that are unfairly high or purchasing goods at prices that are unfairly low;
ii. without a legitimate reason, selling goods at below-cost price;
iii. without a legitimate reason, refusing to deal with a business operator;
iv. without a legitimate reason, restricting a trading partner by requiring it to deal only with the dominant operator(s) or with other designated operators;
v. without a legitimate reason, tying goods or attaching other unreasonable conditions to a transaction; and
vi. without a legitimate reason, treating equivalent trading partners in a discriminatory manner with respect to price or other trading conditions.

This list is non-exhaustive and may be amended by China's competition authorities at any time.

2. Recent Enforcement Trends

In recent years, Chinese competition authorities have significantly increased investigations of both Chinese and foreign companies for alleged violations of competition law.

[130] Article 17 of the Anti-Monopoly Law.
[131] Article 18 of the Anti-Monopoly Law.
[132] Article 19 of the Anti-Monopoly Law.
[133] Article 17 of the Anti-Monopoly Law.

The National Development and Reform Commission (NDRC), China's competition authority responsible for price-related offenses, has imposed significant fines on companies for breaches of competition law: in particular, on companies found to have participated in hardcore cartel agreements (i.e., price-fixing agreements, see section (d) on horizontal restraints below). Since 2013, NDRC has also prioritized investigations concerning RPM, and large fines have been imposed (see section (b) on pricing issues below). NDRC reportedly imposed a record total fine of RMB1.58 billion in 2014.

The State Administration of Industry and Commerce (SAIC), China's competition authority responsible for non-price related offenses, has also significantly increased investigations into alleged abuses of dominance (see section (c) on vertical non-price restraints below). SAIC reportedly imposed a record total fine of RMB14.5 million in 2014, almost triple the level of fine imposed in 2013.

To date, Chinese competition authorities have largely focused their investigations on consumer-oriented sectors, such as the automotive, electronics, eye care, milk powder, pharmaceutical, premium liquor and tobacco sectors. Recently, NDRC imposed a fine of RMB449 million on two Chinese premium liquor companies found to have signed agreements with their distributors restricting the minimum resale price of their liquors, and imposed punitive measures on distributors that did not adhere to the RPM restrictions.

B. Pricing Issues

1. Fixing the Resale Price/Retailer Margin

The Anti-Monopoly Law expressly prohibits a business operator from fixing or setting a minimum resale price (i.e., RPM).[134]

It is currently unclear whether RPM is illegal "*per se*" (automatically deemed illegal) in China. NDRC appears to apply a "*per se*" test and has not been inclined to accept "effects-based" arguments that RPM does not have anti-competitive effects. In contrast, the Chinese courts appear to favor a "rule of reason" analysis, where positive and negative effects of RPM are considered. Given NDRC's stance, in terms of compliance with Chinese competition law, business operators should regard RPM as "*per se*" prohibited in China.

Since 2013, NDRC has vigorously investigated and imposed large fines on companies found to have taken part in RPM. Below are examples of recent cases:

i. In August 2013, NDRC imposed a fine of RMB670 million on six baby milk formula manufacturers found to have had agreements in place with their distributors to restrict the resale prices of their products.
ii. In September 2014, NDRC imposed a fine of RMB249 million on an automotive joint venture found to have organized several meetings with 10 of its dealers to sign and implement an agreement that restricted the resale price for automotive sales and repair services.
iii. In September 2014, NDRC imposed a fine of RMB33.8 million on an international car maker found to have entered into dealership agreements that contained RPM clauses, and

[134] Article 14 of the Anti-Monopoly Law.

imposed punitive measures, such as fines, on dealers that did not adhere to the RPM clauses.

In addition to fines, the NDRC is also known to impose "unofficial" penalties on companies under investigation (akin to a settlement or commitment decision). For example, companies in the milk powder and automotive sectors that were under investigation by NDRC for alleged RPM unilaterally announced they were lowering prices in China. Such actions are reflective of NDRC's role as a pricing regulator under the Price Law.

There have been signals from the NDRC that it will continue to focus its investigations on alleged RPM in the near future. This appears consistent with the Chinese Government's broader goal of reducing prices and costs in consumer-oriented sectors.

2. Maximum Prices

There is no indication under the Anti-Monopoly Law that the setting of maximum resale prices is prohibited. Such conduct has, so far, not been tested in any publicly available cases or decisions. However, given that the Anti-Monopoly Law specifically prohibits a business operator from fixing or setting minimum resale prices but makes no mention of setting maximum resale prices, it could be inferred that such conduct is unlikely to be problematic from a Chinese competition law prospective.

3. Recommended Prices

There is no indication under the Anti-Monopoly Law that the setting of recommended resale prices is prohibited. Setting recommended resale prices is a common practice in China, and is likely to be considered permissible by Chinese competition authorities, provided that they do not amount to a fixed or minimum resale price, due to pressure from, or incentives offered by, the upstream business operator.

4. Minimum Advertised Price

There is no guidance under the Anti-Monopoly Law on whether a business operator is prohibited from setting MAPs. Chinese competition authorities have, so far, not made any distinction between a MAP and a minimum resale price. On this basis, and given the NDRC's tough stance on RPM, it is likely that NDRC will consider a MAP to be illegal.

C. Vertical Non-price Restraints

The Anti-Monopoly Law does not expressly address non-price related vertical restraints, such as exclusive distribution, non-compete obligations, territorial or customer restrictions. There is no guidance on the choice of distribution model and whether such a choice has any impact on non-price related vertical restraints. However, non-price related vertical restraints could be considered as "other" prohibited anti-competitive agreements, as determined by Chinese competition authorities, at any time.[135] Further, where such restrictions are imposed by a business operator with a dominant market position, they may be considered an abuse of a dominant market position. The State Administration of Industry and Commerce Rules on Prohibition of Monopoly Agreements (SAIC Rules) indicate that non-price related vertical restraints are analyzed under a rule of reason analysis.[136]

To date, other than cases involving abuse of a dominant position, Chinese competition authorities are not known to have issued any infringement decision for imposing non-price related vertical restraints. In recent years, SAIC has actively investigated and fined business operators for abuses of dominance. Examples include:

i. The SAIC has been investigating Tetra Pak for alleged abuse of its market dominant position, by tying the sale of packaging materials to the purchase of packaging equipment, and price discrimination in favor of large dairy companies.
ii. Microsoft has been under investigation by SAIC in relation to the compatibility of its Windows operating system and Office software with some Chinese software.
iii. In November 2014, SAIC imposed a fine of RMB1.7 million on a Chinese tobacco company based in Jiangsu. The company, being the only tobacco wholesaler licensed in Pizhou city, was found to have imposed discriminatory conditions on retailers, by providing more frequent deliveries and a larger quantity of popular cigarettes to certain retailers.

D. Horizontal Restraints

The Anti-Monopoly Law expressly prohibits (i) price-fixing agreements; (ii) agreements to restrict output; (iii) market allocation agreements; (iv) agreements to restrict the purchase of new technology or new equipment; and (v) concerted refusals to deal, entered into between competing business operators.[137] Chinese competition authorities may, at any time, deem other types of horizontal agreements anti-competitive and prohibited.[138]

Since the inception of the Anti-Monopoly Law, NDRC has aggressively investigated and fined participants in hardcore cartel agreements. For example:

i. In December 2012, NDRC imposed a fine of RMB353 million on six LCD manufacturers found to have held 53 meetings in a five-year period to exchange market information and discuss price fixing on LCD panels in the Chinese market.
ii. In August 2014, NDRC imposed a fine of RMB832 million on seven automotive spare parts manufacturers found to have fixed the prices of spare parts covering 13 product categories, including starters, alternators, throttle bodies and wire harnesses. The companies were found to have held meetings from January 2000 to February 2010 to discuss product prices and implemented agreements over quoted prices for order in the Chinese market.
iii. In August 2014, NDRC imposed a fine of RMB403 million on three automotive bearing manufacturers found to have participated in conferences from 2000 to June 2011. During

[135] Article 14(3) of the Anti-Monopoly Law.
[136] Article 8 of the SAIC Rules.
[137] Articles 13(1) to (5) of the Anti-Monopoly Law.
[138] Article 13(6) of the Anti-Monopoly Law.

the conferences, discussions of the timing and range of increase in the prices of bearings for the China and Asia markets were held, and relevant information was exchanged. The companies were also found to have increased the prices of bearings for the Chinese market, in accordance with the plans made at these conferences.

To date, Chinese competition authorities are not known to have issued any infringement decision for "pure" information exchange among competing business operators, either directly or indirectly through a third party (i.e., in the absence of an express agreement among the participants). However, recent comments by officials of Chinese competition authorities suggest they are concerned that information exchange in certain industries may lead to anti-competitive effects and have begun to examine such activities.

E. Issues with Internet Sales

There is no indication under the Anti-Monopoly Law that restricting internet sales conducted by a reseller is prohibited "*per se*". Such a restriction has so far not been tested in any publicly available cases or decisions. However, a restriction on internet sales by a reseller imposed by a business operator with a dominant market position may be deemed to be attaching an unreasonable condition to a transaction, and considered an abuse of a dominant position, if carried out without a legitimate reason.

Hong Kong

A. The Framework of Competition Law in Hong Kong

1. The Rules Applicable to Distribution Agreements

Hong Kong's competition law, the Competition Ordinance (Cap. 619) (the Competition Ordinance), is not yet in force. The Competition Ordinance is anticipated to come into force in the second half of 2015. Companies will have to comply with the Competition Ordinance from the date it comes into effect, and any continuing conduct at that point in time will be subject to the law and at risk (i.e., there are no grandfathering provisions).

The Competition Ordinance has two key prohibitions: (i) the First Conduct Rule, which prohibits anti-competitive agreements, arrangements and concerted practices (applying to both horizontal and vertical arrangements); and (ii) the Second Conduct Rule, which prohibits abuse of a substantial degree of market power.

The text of the law is drawn from a number of sources, including EU and other competition laws. At the time of writing (January 2015), draft guidelines were under public consultation, which leads to some uncertainty as to how the law will be applied. However, the draft guidelines and various comments prepared by the Competition Commission (the Commission) give some sense of how the law is to be interpreted and enforced when the prohibitions are brought into force. That commentary forms the basis of the views expressed in the following sections.

The Commission has been established to investigate and bring proceedings in relation to alleged breaches of the Competition Ordinance. A specialist division has been established within the Hong Kong High Court, called the Competition Tribunal (the Tribunal), with primary responsibility to hear competition cases and issue decisions on breaches, penalties and other relief. There are no stand-alone rights of action. However, persons who have suffered loss or damage as a result of anti-competitive conduct may bring follow-on claims in the Tribunal, to claim damages and other relief.

First Conduct Rule

The First Conduct Rule prohibits any agreement, concerted practice or decision the object or effect of which is to prevent, restrict or distort competition in Hong Kong. Within this, two types of conduct are identified:

i. serious anti-competitive conduct (price fixing, bid rigging, market sharing and output restrictions); and
ii. other anti-competitive conduct, which comprises any agreement, concerted practice or decision that is not serious anti-competitive conduct, but that nevertheless has the object or effect of preventing, restricting or distorting competition in Hong Kong.

Where conduct falls within the category of "serious anticompetitive conduct", the Commission may take enforcement action against it without warning. Where conduct is not serious anti-competitive conduct, a warning notice must be issued before enforcement action can be taken. If the undertaking complies with the warning notice, it is protected from prosecution. If the undertaking does not comply with the warning notice within the specified time, the Commission may begin enforcement proceedings and the undertaking may be held liable if found to be in breach of the Competition Ordinance, but only for conduct that continued as from the date of the warning notice. The distinction between serious anti-competitive conduct and other anti-competitive conduct under the First Conduct Rule therefore has important ramifications for businesses.

The draft guidelines state that the Commission will consider the following conducts typically to have the "object" of harming competition:

i. directly or indirectly fixing prices or any other trading conditions;
ii. limiting or controlling production, markets, technical development or investment;
iii. sharing markets or sources of supply;
iv. big rigging;
v. exchanging of future price and quantity information;
vi. group boycotts; and
vii. RPM.

Where conduct falls into these categories, it will be regarded by its very nature to be so harmful to the proper functioning of normal competition in the market that there will be no need to examine its effects. In other words, such conduct will be presumed to be anti-competitive. It is important to note that the Commission reserves the right to supplement the above list.

Other conduct may be considered by the Commission to have the effect of harming competition. For such conduct, a warning notice will be issued and the Commission will apply a rule of reason analysis to assess whether, in the circumstances, such arrangements are anti-competitive. The draft guidelines give the following examples of conduct that might fall into this category (although this list is not exhaustive):

i. joint purchasing agreements;

ii. exchange of information other than future price and quantity information;
iii. standard terms and standardization agreements;
iv. membership and certification restrictions;
v. certain joint ventures;
vi. exclusive distribution or customer allocation agreements; and
vii. recommended and maximum resale price restrictions.

It is important to assess the risks in distribution agreements to determine the extent to which vertical agreements (particularly restrictions on distributor pricing and territories) might be regarded as serious anti-competitive conduct and/or as having the object of harming competition. The draft guidelines are not clear on this, except to the extent that they express a view on the current list of by object infringements and state that, with the exception of RPM, which may amount to serious anti-competitive conduct in certain cases, vertical agreements are generally not going to be regarded as falling into the category of serious anti-competitive conduct.

In a departure from the practice in a number of established competition law jurisdictions, the Commission is not proposing any “safe harbors” or block exemptions for companies with low market shares. Accordingly, undertakings generally need to self-assess the potential competition impact of agreements where they are concerned that they might have an anti-competitive effect, and they can, in certain circumstances, seek decisions from the Commission to get some clarity.

Second Conduct Rule

The Second Conduct Rule prohibits the abuse of a substantial degree of market power where the object or effect is to prevent, restrict or distort competition in Hong Kong.

The draft guidelines provide that, in general, an analysis of market share may be useful as an initial screening device for an assessment of whether an undertaking has a substantial degree of market power, and that undertakings are more likely to have a substantial degree of market power where they have high market shares. However, there has been no guidance from the commission as to a specified market share safe-harbor or presumptive threshold over which a substantial degree of market power might be presumed.

The Competition Ordinance provides that the following (among other relevant matters) may be taken into consideration when making a determination:

i. the market share of the undertaking;
ii. the undertaking’s power to make pricing and other decisions; and
iii. any barriers to entry to competitors into the relevant market;

The Competition Ordinance and the draft guidelines expressly refer to the below non-exhaustive examples of what kinds of conduct might be regarded as an “abuse”:

- behavior to exclude competitors (such as predatory pricing, refusal to supply, exclusive dealing, margin squeeze conduct, or tying/bundling of products); and
- behavior that harms consumers (such as limiting production, markets or technical development).

Exclusions and Exemptions

The Competition Ordinance contains a number of exclusions and exemptions. The most relevant in respect of distribution arrangements is an exclusion from the First Conduct Rule for agreements enhancing overall economic efficiency. To benefit from the exclusion, it must be demonstrated that overall economic efficiency is enhanced either by improving production or distribution, or by promoting technical or economic progress, provided that these agreements do not impose unnecessary restrictions and do not eliminate competition in respect of a substantial part of the market in question. The Commission may grant block exemptions for categories of agreement that enhance overall economic efficiency. Such block exemptions are limited in duration and scope.

The Competition Ordinance also contains a general exclusion for agreements of lesser significance, which excludes from the First Conduct Rule all agreements between business operators with a combined annual turnover not exceeding HK$200 million in the preceding financial year. This exclusion does not apply to infringements involving “serious anti-competitive conduct”. Undertakings with an annual turnover of less than HK$40 million are excluded from the Second Conduct Rule.

2. Recent Enforcement Trends

The prohibitions have not yet come into effect and, accordingly, there has not been any competition enforcement action taken to date in the luxury goods and fashion industry in Hong Kong. Press reports suggest that a wide range of sectors could potentially come under scrutiny by the Commission and it has not ruled out the possibility of enforcement action in any sector.

B. Pricing Issues

1. Fixing the Resale Price/Retailer Margin

The draft guidelines state that the Commission will consider RPM (including indirect RPM, such as fixing the distributor’s margin or the maximum level of discount the distributor can grant from a prescribed price level) to have the object of harming competition in violation of the First Conduct Rule, and that such conduct may amount to serious anti-competitive conduct. The Commission’s tough stance on RPM is reiterated in the “The Competition Ordinance and SMEs” brochure published in December 2014, which states that RPM is likely to contravene the First Conduct Rule, unless there is a sufficient efficiency justification for the arrangement.

2. Recommended or Maximum Prices

The draft guidelines indicate that recommended or maximum resale prices will be subject to effect-based analysis by the Commission to determine whether they have the effect of harming competition. Recommended or maximum resale price agreements may give rise to concern where they serve to establish a “focal point” for distributor pricing (i.e., where the distributors generally follow the recommended or maximum price), and/or where they soften competition between suppliers or otherwise facilitate coordination between suppliers. The draft guidelines indicate that an important factor in the analysis is the market position of the supplier – the more market power the supplier has, the more likely it is that the conduct will have the effect of harming competition.

3. Minimum Advertised Price

There is no guidance under the Competition Ordinance or the draft guidelines on whether the setting of a MAP will be considered to have the effect or object of harming competition. Given the Commission's strict approach to RPM, a conservative approach would be to assume that it will consider MAP a form of RPM and that it has the object of harming competition, in violation of the First Conduct Rule.

C. Vertical Non-price Restraints

The Commission has indicated in the draft guidelines that exclusive distribution or customer allocation agreements will generally be subject to effect-based analysis by it to determine whether they have the effect of harming competition. In making the assessment, the Commission will consider factors including how intra-brand and inter-brand competition is affected, the extent of the territorial and/or customer sales limitations, and whether exclusive distributorships are generally common in the markets impacted by the agreements.

To date, the Commission has not provided any specific guidance on other types of non-price related vertical restraints. There is no guidance on the choice of distribution model and whether such a choice has any impact on non-price related vertical restraints. However, the draft guidelines provide that for vertical agreements, as a general matter, competition concerns will only arise where there is some degree of market power at either the level of the supplier, the buyer or at the level of both. Based on these comments, one would expect the Commission to take the view that vertical agreements between small and medium-sized enterprises would rarely be capable of harming competition. Based on the language of the draft guidelines, it is likely that other types of non-priced related vertical restraints will be subject to effect-based analysis on a case-by-case basis. To date, the Commission has taken the position that it will not be issuing any safe harbors or a vertical block exemption.

D. Horizontal Restraints

The draft guidelines state that horizontal agreements may be particularly liable to harm competition, and that the Commission has a strong interest in ensuring illegal practices, such as cartel arrangements, are brought to an end and sanctioned proportionately. Accordingly, strict enforcement against horizontal anti-competitive practices is expected. The draft guidelines set out a list of examples of horizontal conduct that the Commission will consider (a) typically to have the object of harming competition; or (b) may have the effect of harming competition (see section 1(i) above).

The draft guidelines state that the Commission will consider (i) information exchange intended to allow parties to a cartel to monitor whether other parties are complying with the cartel agreement; and (ii) information exchange on future pricing (or elements of pricing) or quantities information, as having the object of harming competition. This includes information exchange via a third party supplier or distributor as a "conduit". Other forms of information exchange generally are expected to be assessed applying an effect-based analysis on a case-by-case basis.

E. Issues with Internet Sales

There is no guidance under the Competition Ordinance or the draft guidelines on internet sales restrictions. In this respect, it remains to be seen what approach the Commission will take. It has previously indicated e-commerce is one of the sectors potentially subject to scrutiny.

V. Conclusion

Fashion and luxury goods makers expose themselves to a number of risks under the antitrust and competition laws of jurisdictions across the globe when they attempt to control pricing and distribution. The level of these risks depends greatly on the jurisdictions where lawsuits may be brought and the type of conduct that is at issue. Vertical restrictions on price are generally riskier than non-price vertical restrictions, and horizontal restrictions are almost always the most legally risky. In particular, restrictions regarding online sales are increasingly being scrutinized, especially under the competition rules of the EU and its Member States (and certain Member State authorities take a very strict view of e-commerce restrictions). Where the relevant rules are infringed, high fines may be imposed. However, fashion and luxury goods makers can generally reduce this risk and achieve their business objectives by consulting with counsel to structure their distribution systems to comply with the applicable legal restrictions.

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The global luxury market has been expanding steadily, reaching an impressive US$254 billion in 2014. Not only is the sale of luxury and fashion goods expanding geographically, it has also been spreading across the world, due to the increase in touristic spending.

The Baker & McKenzie *Global Legal Guide for Luxury & Fashion Companies* was a natural outgrowth of these efforts, seeking to provide our clients with a comprehensive reference point for the contemporary, cutting-edge issues facing the industry. In this guide, you can tune into "playlists" for identifying, registering and enforcing intellectual property rights. Over 225 lawyers and economists from our firm have contributed to this guide and we hope that you find it a useful practical reference for questions that you may have about this fascinating and constantly changing industry.

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