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GENERAL NOTICE

NOTICE 456 OF 2006

DEPARTMENT OF TRADE AND INDUSTRY CONSUMER AFFAIRS (UNFAIR BUSINESS PRACTICES) ACT, 1988

I, Mandisi Mpahlwa, Minister of Trade and Industry, do hereby, in terms of section 10(3) of the Consumer Affairs (Unfair Business Practices) Act, 1988 (Act No. 71 of 1988), publish the report of the Consumer Affairs Committee on the investigation conducted by the Committee pursuant to Notice 1868 as published in Government Gazette No. 28138, dated 13 October 2005, as set out in the Schedule.

MANDISI MPAHLWA
MINISTER OF TRADE AND INDUSTRY

SCHEDULE

CONSUMER AFFAIRS COMMITTEE

**REPORT
IN TERMS OF SECTION 10(1) OF THE
CONSUMER AFFAIRS (UNFAIR BUSINESS PRACTICES) ACT, 1988
(ACT 71 OF 1988)**

REPORT 124

A FURTHER INVESTIGATION INTO PARALLEL IMPORTS OR GREY GOODS

A further investigation into parallel imports or grey goods

1. Introduction

The former Business Practices Committee (BPC) administered the Harmful Business Practices Act, 71 of 1988. During May 1999 several amendments were made to the Harmful Business Practices Act and from 9 May 1999 the amended act, called the Consumer Affairs (Unfair Business Practices) Act, 71 of 1988 (the Act), is administered by the Consumer Affairs Committee. In this report the word Committee will be used when referring to either the Business Practices Committee or the Consumer Affairs Committee. Occasionally there will be a reference to the former BPC. A reference to the Committee and/or the Act before 9 May 1999 would refer to the Business Practices Committee and the Harmful Business Practices Act. Other references to these two terms would refer to respectively the Consumer Affairs Committee and the Consumer Affairs (Unfair Business Practices) Act, 71 of 1988.

The Committee was established in terms of section 2 of the Consumer Affairs (Unfair Business Practices) Act, 1988 (the Act). The purpose of the Act is to provide for the prohibition or control of certain business practices and related matters. An unfair business practice is any business practice which directly or indirectly, has or is likely to have the effect of harming the relations between businesses and consumers, unreasonably prejudicing any consumer, deceiving any consumer or unfairly affecting any consumer or natural person.

The Act confers wide investigative powers on the Committee. The Committee may conduct two types of formal investigations. Firstly, in terms of section 8(1)(a) of the Act, the Committee could undertake investigations into any unfair business practices of a particular individual(s) or business(es) which the Committee believes exists or may come into existence. Secondly, the Committee may investigate any business practice being applied by persons or businesses in general for the purposes of creating or maintaining an unfair business practice. Section 8 investigations are known as formal investigations.

The Committee could also undertake preliminary or informal investigations in terms of section 4(1)(c) into the business practices of persons or businesses. The purpose of these investigations is to enable the Committee to make a more informed decision as to whether a section 8 investigation is called for. Notices of section 8 investigations are published in the Government Gazette. This does not apply to section 4(1)(c) investigations.

The Committee reports to the Minister of Trade and Industry (the Minister) on the result of a section 8 investigation. If the Committee, after an investigation, believes that an unfair business practice exists, or may come into existence, and is not satisfied that the unfair business practice is justified in the public interest, the Committee recommends to the Minister what action, in terms of section 12 of the Act, he should take to ensure the discontinuance of the unfair business practice. The orders of the Minister are published

in the Government Gazette and a contravention of the Minister's order constitutes a criminal offence.

2. Investigation into parallel imports

As a result of complaints against parallel imports, the BPC undertook an investigation into parallel imports in terms of section 8(1)(b) of the Harmful Business Practices Act. Notice of the investigation was published under Notice 152 of 1993 in Government Gazette 14579 of 19 February 1993. Report 33: Parallel Importation was published under Notice 1077 in Government Gazette 15223 of 29 October 1993.

3. Report 33

Section 3 is a verbatim reproduction of the BPC's Report 33. To distinguish Report 33 from the rest of this report, the text of Report 33 is printed in font Courier New as opposed to the text of this report which is published in font Arial. Report 33 is also indented.

Introduction

The business practice of parallel importation and the subsequent trade in "grey goods" can be said to occur "when goods which were intended for sale in one national market are exported from their original destination to another country."¹ Complaints have been registered with the Business Practices Committee to the effect that consumers are exploited by grey marketers and that the trade in "grey goods" constitutes a harmful business practice. According to one submission to the Committee "parallel importers are in the nature of parasites."² The practice is also claimed to be potentially harmful to the competitors of grey marketers and consumers of such products alike.

1 Simon Horner Parallel Imports 1987 Collins Professional Books London. See also K Takamatsu "Parallel Importation of Trademarked Goods: A Comparative Analysis" 1982 Washington LR 433: "The importation of genuine goods by someone other than the designated exclusive importer is usually referred to as 'parallel importation'".

2 See also L J Minehan: The Gray Market: A Call for Greater Protection of Consumers and Trademark Owners 1991 University of Pennsylvania Journal of International Business Law 457.

Terms of reference

As a result of the complaints received the Business Practices Committee undertook an investigation in terms of section 8(1)(b) of the Harmful Business Practices Act.

The notice of investigation, published as Notice 152 of 1993 in Government Gazette 14579 of 19 February 1993, referred to the business practice where goods which are imported into the Republic of South Africa -

"are sold or offered for sale as new goods -

- (a) in a form or state which is not approved by the owner of the trade mark under which they are sold or offered for sale;
- (b) in a form or state which does not conform with the requirements or technical specifications with which such a product must comply in order to be sold lawfully or to enable it to function properly or safely in the Republic of South Africa;
- (c) are represented as having a sponsorship, approval, status, guarantee, repair and back-up services, affiliation or connection recognised by the proprietor of the trade mark under which they are sold, if this is not the case."

Background: Distribution systems and license agreements

The products (and services) consumed and used by consumers originate in a complex and costly process. Products are generated only if consumers demand them and are able to afford them. The substantial investment of both time and money required for developing any product would be wasted in the absence of an appropriate system for the distribution of the product to the point of sale.³ Investment in production is furthermore only induced when circumstances are such that investors are confident that they will be able to generate a fair return on their investment. This requires effective legal protection for inventions and other forms of immaterial property rights such as trade marks.

3 See D. G. Goyder EC Competition Law 2ed 1993 Oxford University Press, New York, 211.

The issue of parallel importation can be meaningfully considered only within the context of the broader framework of commercial distribution systems. Such systems form an integral and indispensable part of the environment required for satisfying consumer needs. All successful distribution systems are based on the principle of voluntary exchange.

Manufacturers have to select the methods and routes (distribution channels) that will be used to move their products to their target markets. Some manufacturers prefer to sell directly to consumers. This decision, depending on the type of product, invariably results in the manufacturer having to establish sales offices or branches. This course of action generally increases the financial burden of manufacturers and may significantly complicate their management functions.

An often preferred alternative is to make use of middlemen for the distribution task, either in conjunction with, or to the exclusion of direct selling by the manufacturer. Middlemen are independent firms linking manufacturers and consumers. The "independence" of the middleman refers to the fact that it is not controlled by a manufacturer. Middlemen form the backbone of distribution channels in most countries.

Middlemen generally enter into agreements with manufacturers whereby they are commissioned to sell part or all of the manufacturers' products in particular territories. In many cases middlemen have long term relationships with their principals.

In international trade a common method of marketing in a foreign country is by exporting through local middlemen because they know and understand the local market and the local marketing environment. As in many other countries it is also common in South Africa for middlemen to be appointed by foreign manufacturers to market their products locally. Such appointments are usually in terms of license agreements.

In the majority of cases licensed importers (middlemen) are appointed by their foreign principals as the exclusive importers of the principals' products. The licensee obtains access to the products of the manufacturer who, in turn, obtains access to the market through the licensee. These

appointments in general make provision for the principals to supply goods to the licensed importers on an exclusive basis as regards a particular country or region. In return the licensed importer assumes certain obligations, such as marketing, after-sales service and the protection of the goodwill acquired, by ensuring consumer protection and satisfaction. This arrangement may be of considerable benefit to the consumer.

So-called "exclusive agencies" typically restrict competition between middlemen and principals or between middlemen and other middlemen, usually with regard to certain territorial or other market defining limits. Such licence agreements usually embody an undertaking that the manufacturer will refrain from supplying other middlemen in a particular territory or from supplying a certain segment of the market, or will refrain from competing with the appointed agent by selling directly to consumers in the particular market. In the past this has often effectively excluded other sources of supply. In the global international market of today with expanding mobility of trade, physical restrictions on channels of supply are increasingly falling away. In many markets there is also a hostile attitude towards contractual restrictions on channels of supply.⁴

Licence agreements between foreign principals and local distributors or licensees, amongst others, typically provide for the obligation of the parties to reach agreement on a fiscal year business plan dealing with marketing, sales, support, administration and finance.

The business plan relating to sales may include sales quotas and provide for matters such as the licensee's commitment to maintain adequate demonstration equipment, means of display and levels of investment in the training of sales personnel.

The support section of the business plan may include requirements on the licensee's commitment to maintain adequate support equipment and parts inventory, to train its service and support personnel, and to render an after-sales service. This obviously results in additional expense on the part of the local distributor, since capital is tied up in maintaining these stocks. Training is sometimes provided

4 Horner, 180

by the foreign principal. The local distributor's failure to achieve sales quotas or maintain support commitments stated in the business plan may constitute grounds for either reducing compensation by the foreign principal payable to the local distributor for maintaining the necessary infrastructure, or for termination of the distribution agreement.

The local distributor is sometimes obliged to ensure that imported equipment is approved by the South African Bureau of Standards (SABS) and that it meets various South African legal and technical standards. Compliance with such requirements incurs costs for the local distributor.

Pursuant to such agreements, a large number of local distributors have established branches in South Africa in the development of an infrastructure for sale and before and after-sales service of foreign principals' products. A number of licensees have well established networks of authorised distributors and dealers. This represents substantial investment in local distribution infrastructure.

Certain licensed importers expend vast sums of money in the marketing (including advertising) of the products concerned. The objective of the importers' marketing campaigns is usually to enhance the image of their brand names and revolves around advertising, sales promotion and sponsorships.

In certain instances the licensed importers are recorded as registered users of the brands in terms of the Trade Marks Act, Act No. 62 of 1963. This is done to enable the registered users to take an effective part in guarding the interests of their foreign principals. It is a condition of a Registered User Agreement, as required by the Trade Marks Act, that strict quality control must be maintained by the trade mark proprietors (foreign principals) over the use of the subject marks by the licensed importers. Foreign principals often stipulate the right to inspect the premises of the registered users (licensed importers) so as to ensure that their standards are maintained. The Trade Marks Act requires that such quality control must in fact be implemented.

The practice

There are many descriptions of parallel importation or grey marketers. For example it has been stated that:

"Grey marketers are firms which specialise in the parallel importation and sale of grey products via distributors of the foreign principal ~~of~~ the local licensee based in other parts of the world, in breach of those distributors' obligations to the foreign principal."

"... grey goods are goods which are imported and sold without a guarantee from the manufacturer or his authorised agent"

Grey goods are "products imported without the sanction of the appointed agents."

"Trading in 'grey goods' is a term used when parallel importation takes place. Parallel importation again takes place when a third party acquires branded goods from a source abroad other than the producer of those goods, imports such goods into South Africa and sells them directly to consumers or to retailers who sell to consumers."

It is a significant feature of parallel importation that although the goods involved are sourced indirectly from the foreign manufacturer, they are not distributed through its preferred or approved distribution channel.⁵

In a representation submitted to the Committee on behalf of a substantial number of licensed importers and distributors of hi-fi equipment, television equipment, photographic equipment, video cameras computers and watches ("licensed distributors") it was stated that parallel importers tend to enter markets in which demand for particular products have already been stimulated, thus reaping where they have not sown:

"Generally speaking, they do not advertise or promote their grey goods at all; they are content to allow the

⁵ Parallel importation should be distinguished from the trade in counterfeit goods, i.e. the trade in goods which themselves are not sourced from or approved by the owner of the trademark in the goods.

licensed distributors to expend the money and effort necessary to stimulate and maintain the demand for the product. As a result they do not incur costs in connection with the sale of the grey goods other than the acquisition costs and they can generally offer the product for sale at a lower price than the regular distributor. Ultimately, this means that they are able to skim the most profitable end of the market, thus reducing the funds available to licensed distributors to invest in new and more specialised ventures."

The licensed distributors also raise the argument that if the licensed distributors do not enjoy the full benefit of their efforts in stimulating sales of his goods due to the intervention of grey marketers, the viability of their businesses are called into question. It is said that this will then result in a lowering of the standard of back-up, maintenance and guarantee facilities:

"As the lifespan of products lengthens due to advances made in technology and design of consumer electronics, the maintenance situation becomes more and more important. A licensed distributor cannot continue providing a quality back-up service predicated upon a particular level of profit if that profit is not being realised. He is forced to cut his costs in order to keep his business viable."

It is furthermore alleged that grey marketers as a rule do not disclose to consumers that they are not authorised dealers of the foreign principal or the local licensed importer. They purportedly do not disclose the fact that they have neither the benefit of being authorised dealers nor the obligations attached thereto, to the prejudice of consumers.

The effect on consumers is said to be that they may be misled to believe that they enjoy the commercial and contractual support of both the foreign principal and its local authorised distributor network. In short, they rely upon the good name and goodwill attached to the brand name which the authorised distributors maintain at considerable cost. The consumer's expectations may then be disappointed when any required after sales service is of an inferior standard. According to the licensed distributors they are compelled to provide a repair service even in respect of goods which they did not sell, in order to maintain goodwill

in respect of particular product brands.⁶ This is then in effect a subsidy to the grey marketer.

In addition to the alleged harmful effects on consumers, this situation is asserted simultaneously to damage the good name of the foreign principal and its local authorised distributor, which may have expended considerable effort and money over many years (up to the past 25 years) to enhance and maintain their reputation by observing the international standards of the foreign principal. It was submitted that the scale of the phenomenon of parallel importation is such that international investors may be discouraged from investing in South Africa and may even withdraw from the country due to falling returns on investment in markets contaminated by parallel importation.

It was submitted by the licensed distributors that if the trade in grey goods attains a sufficient scope, the market for the licensed distribution of goods sold under the licensed brands could be seriously damaged. The argument is made that if the licensed distributors do not derive sufficient revenue from the sale of their branded goods, they will be faced with increasingly depressed trading conditions, until they may be forced to discontinue trading operations. This would leave the consumer at the mercy of unstable and unreliable distribution systems operated by enterprises who have already demonstrated their reluctance to invest in the necessary support systems required for adequate after sales service.

Much information was placed before the Committee to the effect that local licensed distributors have suffered severe financial setbacks over the last few years. Trade unions whose members are employed by licensed distributors have also expressed disquiet about parallel importation, believing that the employment interests of their members are affected thereby.⁷

6 See Comment: "Applying Grecian Formula To International Trade: K Mart Corp v Cartier, Inc and the Legality of Grey Market Imports" 1989 Virginia LR 1397, 1417.

7 Importers of the licensed brands allege that they retrenched between 20 per cent and 40 per cent of their staff from September 1991 to April 1993. They state that such staff retrenchment is at least partly attributable to the sale of grey goods and it is feared that if the practice of parallel imports, coupled with illegal imports, does not cease, further major retrenchments will take place.

Licensed distributors claim that, as a general rule, parallel importers do not provide service and back-up facilities, and that even when they do, the quality of such facilities compares poorly with the numerous standards required by foreign principals and observed by the licensed distributors. It was alleged that while the resulting cost savings may be reflected in the prices of the parallel importer, the consumer is not adequately informed that he may have to do without guarantee and other back-up services, should a malfunction in the product occur.

Other accusations levelled at grey marketers include their alleged failure to comply with a variety of local legal product specifications and other requirements. It was also submitted that the products sometimes distributed by unauthorised dealers might have been designed for different operating conditions, so that consumers will be likely to experience product malfunctions when they acquire such products which were not intended or designed for local conditions.

Certain products, such as television sets and video recorders, are manufactured overseas specifically to meet South African specifications. Grey goods are frequently adapted for use in areas other than South Africa and will not operate effectively in South Africa. Consumers who purchase such goods are thus prejudiced.

According to one submission all fax machines and telephone attachments imported into South Africa by authorised importers are specifically modified, at the distributor's cost, to conform to legal requirements regarding protection against lightning. All electrical and electronic equipment imported into South Africa must comply with the requirements set by the SABS for the emission of interference with radio and TV broadcasts.⁸ Only approved apparatus may be connected to the telephone network. Where it is found that unauthorised apparatus, irrespective of the type, is connected to the telephone network, it is summarily

⁸ Regulation 68B of the Radio Regulations, as amended by Government Notice No. R.2247 of 29 November 1974, provides, for example, that no person shall import for sale or manufacture for sale, any apparatus except the apparatus in Schedule A, paragraph A3 (a) (v) and (d) to these regulations, unless such apparatus in respect of electromagnetic radiation properties corresponds to a model of such apparatus in respect of which a certificate in the form set out in Schedule B to these Regulations has been issued by the Postmaster General.

disconnected and could result in the suspension of the client's telephone service. The parallel importers allegedly fail to comply with these requirements. Allegedly "hundreds" of parallel imported fax machines, telephones and telephone answering machines are disabled annually because they have not been modified in accordance with telecommunications requirements.

Television sets and video recorders require channel 13 for receipt of the South African Broadcasting Corporation's TV1 channel in the Johannesburg area. When such a product is not correctly adjusted for South Africa, it will not function properly in this country, although the product itself may be said to be technically in working order.

The allegation of evasion of import duties and illegal imports by grey marketers was raised in a number of submissions. A major discount group alleged that in many instances grey importers deal in products that are smuggled through customs or are under invoiced. In both cases there is a large amount of revenue lost to the fiscus, and gained by the grey importer. According to one estimate R100 million rands worth of consumer electronic products are either smuggled or illegally imported into the country. (The Committee was informed that it is relatively easy to avoid payment of duties).

The case of the licensed distributors against the grey marketers can be summarised as follows:

The grey marketers compete unfairly with the licensed distributors and to the detriment of the consumer. They are able to offer lower prices to consumers because they allegedly fail to:

- (a) service and fund the infra-structure necessary to provide the consumer with after-sales service maintained by the local licensee and its dealer and distribution network;
- (b) as a rule, spend money on the promotion of the foreign principal's products, exploiting the promotional activities of the local licensee;
- (c) maintain sufficient levels of stock or of parts. (In order to provide servicing and guarantee facilities, the licensed distributors are obliged to maintain stocks and spare parts for the

products they import and sell. One distributor reports importing "... approximately R3 million Rand worth of spares and hundreds of thousands of Rands spent on test equipment per annum".);

- (d) obtain SABS approval for the equipment which they import. (There is accordingly no guarantee that these goods which were not necessarily destined for South Africa, will meet South African specifications. The failure of a firm to comply with prescribed specifications may confer a cost advantage. This is the case, for example, when there are technical specifications on a product which might increase its price, and products are then imported from countries with technical standards in respect of which compliance is cheaper);
- (e) provide personnel with proper training in the principal's equipment and more particularly in respect of new equipment and accessories;
- (f) carry a full range of the principal's equipment, complementary products and accessories or of parts; and
- (g) pay tariffs and duties that are levied on goods imported into the country or pay certain onerous costs which the licensed distributors have to pay.

In justification of parallel importation it was submitted that the authorised local distributors themselves are frequently unable or unwilling to support all the products of a foreign principal manufacturing a wide product range.

The allegation that grey importers do not render an after-sales service is denied by a grey importer:

"In our experience we have been able to parallel import numerous items and offer these for sale at retail at a reasonable profit at a price equal or lower to the local distributor's wholesale price to the trade. Included in our pricing structure is an allowance for after-sales service and a guarantee which is often accounted for a one-for-one replacement of a defective item with a new item. It cannot be stated that parallel importers generically fail to offer an

inadequate or inferior after-sales service and warranty."

It is also alleged that, like the licensed distributors, the parallel importers have both good and bad elements. These range from the true fly-by-nights to the firms who have full technical and spares back-up and an established and long term client base. It is also alleged that regarding some products this expertise is not even provided by any licensed distributors.

The Committee was presented with evidence in the form of letters from consumers who experienced difficulties after having bought grey goods and their dissatisfaction in this regard. Such evidence also abounds in respect of the licensed distributors. The evidence provided is strongly indicative that the activities of some grey marketers are indeed harmful to consumers. By the same token, however, it is also clear that not all grey marketers are guilty of malpractices or even criminal behaviour.

Evaluation

The issues surrounding parallel importation are generally accepted as complex. From the submissions received by the Committee considerable difference of opinion is apparent. Opposite points of view are advanced with equal vigour.

The complaints and allegations concerning the activities of grey marketers cover a multitude of sins. The Committee proposes to deal with the different issues separately. The Committee is indeed of the view that a distinction must be drawn between parallel importation and grey marketing on the one hand, and the activities of particular parallel importers or grey marketers on the other.

The mere fact that the seller claims to have a distribution agreement with a manufacturer does not necessarily provide protection to the consumer. The distributor may, for example, become insolvent.

The trend is to move away from regulated markets and protectionism. Globally an important objective of governments is to minimise legislative regulation of commerce. With respect to regulation it appears illogical that a government should seek to enforce a right of

exclusivity (exclusivity or monopoly may be synonymous) not granted by a foreign manufacturer or patent holder, particularly if that right of exclusiveness couldn't be protected under the law of the product's country of origin.

It must be emphasised that the Committee's sole function is protection of the consumer from exploitation in the form of harmful business practices. Protecting licensed importers could ultimately do the economy more harm than the importation of products which do not match local conditions. This would be the wrong solution for the licensed distributors' problems. The consumer also has the right to buy goods for which there is no warranty or back-up service, provided he is fully aware thereof and makes an informed decision to purchase products on this basis.

The argument could be made that by prohibiting parallel importation or by imposing restrictions on parallel importation the distribution network of the licensed dealers and their investment in the local distribution system will be protected. This would be a false argument. The only sustainable protection for this investment is competitive and productive superiority. If parallel importation threatens the local industry that industry would per definition be uncompetitive. Protecting any uncompetitive industry involves costs that ought to be carefully calculated. If parallel importation is facilitated by import and excise duties and surcharges, the problem should rather be addressed at its origin. Tariffs and the protection of local industries are the responsibility of the Board on Tariffs and Trade.

Parallel importers are usually small firms. For sound economic reasons, such as the creation of jobs, small business is encouraged by Government. Prohibiting parallel imports could spell the death-knell for many small firms with implications for unemployment.

Failure to disclose unauthorised source

Judging from the submissions made to the Committee it is a fairly widespread practice where parallel imported goods are concerned for the importer to fail to inform the customer that the goods will not carry after-sales support from the authorised dealer network. In stead the customer may be informed that the seller will make good all warranties. It

is only when this fails that the customer sometimes turns to the licensed dealer with his complaint.

No seller should make any misrepresentation to a prospective purchaser, either expressly or tacitly. Naturally, such misrepresentation would include purporting to be an agent or dealer of the manufacturer or official distributor if this were not the case. Nor should any seller inform the consumer that the manufacturer or local distributor accepts responsibility for warranty or other repairs if this is not the case.

The consumer who believes that he will be able to rely on the after-sales services and brand support of the authorised distributor, is likely to be prejudiced if such support is non-existent. The conduct on the part of the parallel importer may fall short of representing the goods as having a sponsorship, approval, status, guarantee, repair and back-up services, affiliation or connection recognised by the proprietor of the trade mark under which they are sold. The mere sale of a branded product could be argued not to amount to such a misrepresentation.

The Committee is of the opinion that the consumer has the right to be informed by a dealer whether or not the dealer is recognised by an authorised importer as forming part of the authorised importer's appointed distribution network. It would appear impractical, however, to impose an obligation on all retailers/dealers to have to impart such information with every consumer transaction, regardless of the circumstances. This would even constitute a burden for authorised agents. It should be possible, however, for dealers to clearly indicate in their warranty related literature, and where appropriate on all sales receipts -

- (a) whether any guarantee is supported by the manufacturer;
- (b) whether the guarantee is supported by the seller only and/or any organisation unrelated to the manufacturer or the licensed distribution network, specifying that the consumer shall not be entitled to any rights of recourse for repair or replacement against the licensed dealer network or the manufacturer, except as provided by law; and
- (c) if there is no guarantee.

Dealers should refrain from misrepresenting the licensed distributors' support for any product. The dealer must also comprehensively inform the customer as to its own obligations for after-sales service, if any. Consumers moreover have a duty to obtain relevant warranty information. It should be pointed out that failure to comply with a consumer code could result in the institution of a formal action in terms of the Harmful Business Practices Act.

Failure to deliver after-sales service

It is more difficult to assess this allegation. There are many consumer complaints about poor or indifferent service even on the part of established firms. The Committee nevertheless accepts that some unscrupulous grey marketers lack in commitment and resolve in supplying a firmly founded after-sales service. If information were to be presented to the Committee to the effect that a particular dealer, whether grey marketer or authorised distributor, repeatedly fails to render agreed after-sales service, this may cause the inference to be made that such firm is committing a harmful business practice, resulting in steps being taken in terms of the Harmful Business Practices Act.

Collapse of the established distribution system

It appears from the financial information supplied to the Committee that some of the exclusive distributors have indeed experienced extremely adverse trading conditions. It cannot be accurately quantified to what extent the activities of some of the grey marketers have been instrumental in the problems experienced by the authorised distributors. That some grey market activity has played a role seems indisputable. To the extent that these unfortunate consequences stem from the conduct of grey marketers, it is trusted that the measures proposed to curb irresponsible grey marketing will make a contribution in reducing, if not eliminating, these consequences.

The Committee has sympathy for the licensed importers' concern regarding retrenchments. The licensed importers argue that the retrenchments are at least partly attributable to the sale of grey goods. However, another argument could be that the importation of grey goods gave

rise to competition and the latter caused retrenchments in some firms whilst it created jobs in others. Obviously South Africa's dire state of the economy also contributed to the retrenchments, and other sectors of the economy have been affected equally or even more severely.

Disincentive to foreign producers and investors

Being aware of the crucial importance of international investment and trade links for the consumer, the Committee is naturally concerned that foreign producers and investors should feel discouraged from entering the local market. It should be taken into consideration, however, that official policy concerning parallel importation in other countries has tended not to prohibit parallel importation as such. In some cases parallel importation is even protected. The Committee does not believe that it is parallel importation into any given market which fundamentally determines the attractiveness of that market to foreign investors. According to the National Consumer Counsel (UK) foreign direct investment may be influenced more critically by factors such as the local market size, levels of skill and education, technical and managerial skills, the real costs of transferring the technology, transport costs, and the political and economic stability of the country.⁹

It was stated in the submission on behalf of the licensed distributors that their foreign principals strongly supported their views. The foreign principals will apparently do everything in their power to prevent grey goods from being imported into South Africa. They are, however, in effect helpless in this regard. The crux of the matter is that grey imports are only possible because of the actions of some nonconformist foreign distributors or licensees and, more specifically, the existence of separate markets for products.¹⁰ It is surely the manufacturers' duty to keep their distributors or licensees in line and not that of the South African authorities.

The manufacturer should contract with its distributors the

⁹ International Trade and the Consumer: Working Paper 6: Intellectual Property - The consumer view of patents, copyright, trademarks and allied rights 1991, 18.

¹⁰ Horner 2.

exclusiveness of supply in a certain area along with the exclusion of supply to any other areas. If the manufacturer is unable to do so, or is precluded from doing so by the laws of his own country, then South African law should hardly act on the supplier's behalf.

Inappropriately designed or adjusted products

As a general proposition consumers are entitled that goods purchased should operate in the way that the type of product is designed to operate and be fit for the purposes for which such products are normally intended, irrespective of whether the product is distributed by a licensed distributor or a parallel importer. Should information come to the attention of a licensed distributor that a particular parallel importer sells a branded good which is not properly designed or adjusted for local conditions, it should place specific information to this effect at the disposal of the Committee which can then deal with that specific complaint.

The Committee also received a submission regarding the grey importation of pharmaceutical products and the potential harmful effects thereof on the consumer. The Committee is of the view that this issue ought to be more properly dealt with by the Medicines Control Council.

Smuggling and tariffs

It should be pointed out that duty evasion and illegal imports are not issues of parallel importation. They are issues of unethical businessmen running unethical businesses. If there are shortcomings in the enforcement of customs duties such shortcomings will not be cured by placing restrictions on parallel importation. These problems are more appropriately addressed by the customs authorities.

Counterfeit products

It has been said that the existence of parallel distribution channels facilitates the marketing of counterfeit products. The Committee believes that the issue of counterfeit products should be addressed directly in terms of the relevant legal structures, and not indirectly via an attack on parallel importation.

Other legal requirements

Parallel importation may also involve the sale of goods in a form or state which does not conform to the requirements or technical specifications with which such a product must comply in order to be sold lawfully or to enable it to function properly or safely in the Republic of South Africa. While a general prohibition on the sale of goods failing to conform to various statutory requirements might be the preference of the licensed distributors, the Committee is of the view that the enforcement of such prescribed requirements is a matter for the relevant policing authorities.

Protection under intellectual property law

In the recent judgment of *Frank & Hirsch (Pty) Ltd v A. Roopanand Brothers (Pty) Ltd* (Appellate Division, unreported) an interdict was allowed against infringement of copyright in the get-up of a product when the product was imported and sold in that get-up. The foreign owner of the copyright had assigned to its local licensed distributor its South African copyright. The local licensee to whom the copyright had been assigned was deemed to be in the same position as if the imported article had been made in South Africa. The effect of this judgment is that the position of the licensed distributors against parallel importers is clearly strengthened where assignment of copyright is obtained.

Conclusion and recommendations

As the Committee has recognised, the problem of parallel importation has multiple facets, which are better addressed by focusing on causes than on symptoms. In its view the issue can further be dealt with in terms of a consumer code which will essentially make provision, for the following, namely:

- (a) for dealers to indicate clearly in their warranty related literature, and, where appropriate, on all sales receipts -
 - (i) whether any guarantee is supported by the manufacturer;

- (ii) whether the guarantee is supported by the seller only and/or any organisation unrelated to the manufacturer or the licensed distributors network, specifying that the consumer may not be entitled to any rights, including rights for repair or replacement against licensed dealers of the product or the manufacturer, except as provided by common law or statute; and
 - (iii) if there is no guarantee.
- (b) for dealers who have been notified by or on behalf of the manufacturer that goods being sold by the dealer are in a form or state which is not approved by the owner of the trade mark under which they are sold or offered for sale, to inform customers accordingly;
 - (c) imposing an obligation on retailers to refrain from representing goods as having a sponsorship, approval, status, guarantee, repair and back-up services, affiliation or connection recognised by the proprietor of the trade mark under which they are sold.

The actual content of the envisaged code should, however, be open to consultation with all interest groups. Written submissions are accordingly herewith invited with respect to such a code.

4. Comments on Report 33

In Report 33 the arguments for and against parallel imports in general were set out. These arguments and counter arguments still apply. The BPC did not recommend that the Minister invoke any of the powers that he has in terms of section 12 of the Act. In its view the issue could have been dealt with in terms of a consumer code which should have ensured *inter alia* that consumers be informed whether any warranties are supported by the manufacturer or whether the guarantee, if any, is supported by the seller and/or any business unrelated to the manufacturer or the licensed distributors network. The proposed code had to provide for a mechanism to impose an obligation on retailers to refrain from representing goods as having a sponsorship, approval, status, guarantee, repair and back-up services, affiliation or connection recognised by the proprietor of the trade mark under which they are sold.

5. The Consumer Code for Electronic Equipment

The BPS developed a Consumer Code for Electronic Equipment which was released during July 1995. As the name indicates, the code was primarily aimed at the electronics industry, and was supported by the then Business Equipment Association, the Electronics Industry Federation, the Radio and Television Manufacturers' Association, the Radio and Television Distributors' Association and the Furniture Traders' Association of South Africa.

The purpose of the code was to provide guidelines to sellers of unauthorised and authorised electronic products. The code obviously had no legal standing. While the code merely set out what the BPC believed to be good sales practice, it should be pointed out that consumer complaints regarding these products could have led and have led to action in terms of section 8(1)(a) or 8(1)(b) of the Act.

On 26 July 1996, for example, under Notice 1006 published in Government Gazette 17320, the Minister declared unlawful the business practice whereby BusinessMann (Pty) Ltd and Mr Mats Viuff, or any employee, agent or representative of BusinessMann, in the course of business, imply or represent that they are authorised local agents of certain brands of electronic goods while that is not the case. The prohibition of the Minister followed the publication of the Committee's *Report 47: BusinessMan (Pty) Ltd*.

In the code two inalienable consumer rights were set out. These rights are the right to choose as well as the right to be informed. The following discussion regarding the two rights is quoted from the code.

The right to choose

The Committee's sole function is to protect consumers from exploitation in the form of unfair business practices by investigating and recommending to the Minister that he prohibit or regulate such practices. Protecting licensed importers by a total ban on unlicensed imports could ultimately be more harmful to the economy than the importation of products which do not match local conditions.

This would deprive the consumers of their right to choose. Consumers have the right to choose to buy goods for which there is no warranty or back-up service, provided they are aware of the facts and make informed decisions to purchase products on this basis. The trend is also to move away from regulated markets and protectionism. Globally an important objective of governments is to minimise regulation of commerce. With respect to regulation it appears illogical that a government should seek to enforce a right of exclusivity (exclusivity or monopoly may be synonymous) not granted by a foreign manufacturer or patent holder, particularly if that right of exclusivity cannot be protected under the law of the product's country of origin.

The right to be informed

Many consumers reasonably assume that sellers are authorised to sell the products they sell and that these products comply with all legislative requirements. Consumers are uninformed and prejudiced when, first, middlemen fail to disclose to them that they (the middlemen) are not the authorised dealers of the foreign principal or the local licensed importer; and second, when they fail to disclose that they have neither the benefit of being authorised dealers nor the obligations attached to them.

The effect on consumers of this non-disclosure is that they are misled into believing that they enjoy the commercial and contractual support of both the foreign principal and its local authorised distributor network. In short, they rely upon the good name and goodwill attached to the brand.

Consumers' expectations may then be disappointed when this after-sales service is not available, even though service of comparable quality may sometimes be available. Authorised dealers complain that they frequently have to disappoint consumers who believe that they qualify for certain after-sales service, the cost of which has to be defrayed out of the sales of "authorised" branded products. The Committee believes that it is in the interest of consumers that this service continues to be available.

No seller may make any misrepresentation to a prospective purchaser, either expressly or by implication. Such misrepresentation would include purporting to be an agent or a dealer of a manufacturer or an official distributor if this were not the case. The purchase habits of consumers are such that the mere sale of a branded product is often sufficient enough to create an impression that the seller is an authorised agent under obligation to an original product manufacturer to supply after-sales service.

To ensure that any such possible misunderstanding is timeously corrected, it is incumbent upon the seller of branded products who does not form part of an existing authorised after-sales service network to inform consumers that they (the consumers) would not qualify for services provided under the auspices of an original manufacturer or authorised agent.

Nor should any seller inform consumers that a manufacturer or local distributor accepts responsibility for warranty or other repairs if this is not the case. Consumers who believe that they will be able to rely on the after-sales services and brand support of the authorised distributor, are likely to be prejudiced if such support is not forthcoming.

The Committee is consequently of the opinion that consumers have the right to be informed accordingly by dealers where the dealers are not recognised by an authorised importer as forming part of that authorised importer's appointed

distribution network. The Committee regards it as the responsibility of sellers of unauthorised branded products to ensure that end users are explicitly informed of the conditions attached to the products prior to the sale. If the product does not have the support of the authorised dealer network he or she has a right to know this and to be informed accordingly.

At times dealers, although part of an authorised importer's appointed distribution network also directly import that same product or brand which in fact would not be serviced by the licensed distributor".

It was stated in the code that as a general rule consumers should be in a position to distinguish between products which have the backing of the manufacturer and products which do not. In view of existing commercial practice a consumer who is not informed otherwise should be entitled to assume that he is purchasing a product with such support.

The code suggested that one way of ensuring that consumers are fully informed of their rights regarding authorised or unauthorised goods will be for unauthorised branded products offered for sale to end users to be identified by a label firmly affixed in a prominent position on the packaging of such products, prior to the product being displayed or sold. To be effective, it was suggested that the label should be prominently affixed to the product if the product is displayed or sold without packaging.

As a general statement it could be said that the code was generally disregarded by grey goods importers. The Committee received complaints from consumers about grey goods on a continuous basis and it was clear that the import of grey goods was not confined to electronic products only. There were parallel imports of nearly all types of products, including agricultural machinery, all types of motor vehicles, golf clubs, motor cycles and pens.

In view of the fact that:

- the Consumer Code for Electronic Equipment focussed on a narrow range of products,
- the Consumer Code for Electronic Equipment is generally disregarded and
- consumers are entitled to choose amongst products and to be informed regarding these products,

the Committee resolved to again investigate parallel imports in terms of the Act.

6. *Notice of the investigation*

The following notice was published on 13 October 2005 under Notice 1868 in Government Gazette 28138

"In terms of the provisions of section 8(4) of the Consumer Affairs (Unfair Business Practices) Act, 1988 (Act No. 71 of 1988), notice is hereby given that the Consumer Affairs Committee intends undertaking an investigation in terms of section 8(1)(b) of the said Act into the following business practice:

The nature and extent of disclosures made by sellers or suppliers of parallel imports or grey goods to consumers with particular reference to whether such disclosures are sufficient to enable consumers to make an informed decision prior to the purchase of such goods. Grey or parallel goods are generally regarded as products sourced from persons other than from a person authorized by the manufacturer to import such goods, or goods that are sourced contrary to any supply arrangement between the authorized local distributor and the manufacturer.

The investigation will encompass (but is not limited to) matters such as the disclosure of the status of such goods, the nature and extent of any warranty provided by the seller or the manufacturer of the goods and any after-sales service provided by the seller or the manufacturer relative to such goods.

Further take notice that any person may, within a period of 21 (twenty one) days of publication of this Notice, make written representations and proposals regarding the investigation to the Consumer Affairs Committee.

7. *The investigation*

It was clear that the facts set out in Report 33 still held. Investigating officials held discussion with various interested parties, such as the South African Bureau of Standards, the Retail Motor Industry and the South African Agricultural Machinery Association and local authorised distributors.

The Committee's biggest concern is that consumers were not informed who exactly held the responsibility for any warranties/guarantees and after sales service in the overwhelming majority of transactions.

There are probably no reputable businesspeople who will deny their clients their basic rights to choose and to be informed.

8. *Conclusion and recommendation*

It is a consumer's basic right to be informed and if relevant information is withheld from consumers, consumers are misled. To mislead consumers is an unfair business practice in terms of the Act and it is not justified in the public interest. It is no consequence whether the withholding of the relevant information took place by accident or design.

It is recommended that the Minister, in terms section 12(6) of the Act, publish the following notice in the Government Gazette:

"In this notice, unless the context indicates otherwise:

1. "Unfair business practice" means:

1.1. the business practice whereby **unauthorised branded products** are **advertised, promoted** and/or offered for sale to **end users** and where **end users** have not been alerted by the **seller** that it:

(a) is not authorised by the manufacturer as an **authorised distributor** of the **branded product**, and

(b) that the authorised South African distributor is under no obligation to honour the manufacturer's warranties/guarantees and/or after-sales support.

Advertised means the use of any direct or indirect communication transmitted by any medium, or any representation or reference written, inscribed, recorded, encoded upon, or embedded within, any medium, by means of which a person seeks to bring to the attention of all or part of end users the existence or identity of a supplier or the existence, nature, availability, properties, advantages or uses of, conditions on or prices at which products may be purchased, leased or otherwise acquired.

Authorised distributor means a duly authorized distributor of the manufacturer of branded products.

Branded product means an imported product which bears, on the product and/or the packaging thereof, the registered brand name or trade mark, of the manufacturer of such product.

End users means any person who purchases a product for his/her own use and not for resale and includes consumers.

Promoted includes advertising, displaying, offering to supply or sell any product in the ordinary course of business; and any other conduct in the ordinary course of business that may reasonably be construed to be an inducement or attempted inducement to an end user to purchase a product.

Sellers are persons who promote, offer for sale or sell any product to end users.

Unauthorized branded product means a branded imported

product imported without the express authorization of the manufacturer and/or owner of the brand name or trademark or of his formally appointed South African distributor; and includes any tangible object or product promoted or offered in the ordinary course of business for sale or supply to end users.

- 1.2. the business practice whereby the sellers of unauthorized branded products do not include, in all forms of advertising or promotion, including in-store promotions, websites and brochures, when every such product is advertised or promoted, the following wording in conspicuous size, without change: "The authorized South African distributor of this product is under no obligation to honour the manufacturer's guarantees/warrantees or to provide after-sales service". The wording " this product is ... ", could be replaced with the words "... these products are ..." if the plural is applicable."
2. The unfair business practice is hereby declared unlawful and persons are hereby directed to:
 - (a) refrain from applying the unfair business practice;
 - (b) refrain at any time from applying the unfair business practice.
3. This notice shall come into operation upon date of publication hereof.
4. On the recommendation of the Consumer Affairs Committee I may, in a particular case, in terms of section 12(6)(c) of the Act, grant exemption from a condition or requirement contemplated in this notice to such an extent and for such period and subject to such conditions as may be specified in the exemption. Such application for exemption must be directed to:

The Chief Director: Office of Consumer Protection
Consumer Affairs Committee
Private Bag X84
PRETORIA
0001

Email: ebimo@thedti.gov.za



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VICE CHAIRPERSON: CONSUMER AFFAIRS COMMITTEE