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Taking Stock

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Contents

Taking Stock

Welcome to the latest edition of Taking Stock, our consumer products and retail law bulletin. This publication explores recent legal developments in the consumer products sector which should be of interest for in-house legal and business personnel alike.

In this edition, we have four articles covering the following:

- A recent court decision providing brand owners with the ability to apply for a blocking order against ISPs in connection with the online sale of counterfeits;
- A review of supply chain risks and the insurance available to mitigate against them;
- An overview of collateral warranties and third party rights; and
- A look at the different approaches competition authorities are taking to online sales restrictions.

If you would like to discuss any of the issues in this edition of Taking Stock or wish to provide any feedback, please contact me, the author(s) of the relevant article or your usual contact at CMS.

We hope that you will be able to join us at our Annual Conference on June 4 2015, details of which are on page 2.

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New kid on the blocking order

E-commerce is Europe's fastest growing retail market. Indeed, as estimated by the Centre for Retail Research, online sales in 2014 in the UK, Germany, France, Sweden, The Netherlands, Italy, Poland and Spain, were valued at in excess of £110 billion. Inevitably, as an unwelcome by-product of this growth, the internet has become an increasingly important channel for trade in counterfeit goods.

Tackling online counterfeit sales is challenging, particularly because locating and enforcing rights against the counterfeiter himself can be extremely difficult and expensive. Brand owners are therefore forced to seek alternative and increasingly innovative methods to tackle such sales.

In this vein, it will therefore offer some comfort to brand owners that, in a landmark decision, the High Court has concluded that the UK Courts have jurisdiction to grant orders requiring Internet Service Providers (ISPs) to block or impede access by their subscribers to websites which advertise and sell counterfeit goods. While orders of this nature are commonplace now in respect of copyright infringement claims, the award of a similar order for a trade mark infringement case is a novel remedy.

Background

The High Court decision from October 2014 concerns an action brought by Richemont against the five main UK retail ISPs seeking orders requiring them to block access to six websites which were advertising and selling counterfeit goods which infringed Richemont's trade marks. In contrast to copyright laws, UK legislation does not expressly provide such a remedy for cases of trade mark infringement. Instead, Richemont sought to rely on Article 11 of the Enforcement Directive which has not been directly transposed into domestic law.

The decision

Notwithstanding this, the Court concluded that it had jurisdiction to grant an order of the nature sought and, furthermore, that to do so was proportionate in the circumstances, taking into account the relative rights of Richemont, the ISPs and internet users.

As a result, the Court granted blocking orders, subject to a number of additional safeguards to ensure that the orders struck the correct balance between the protection of the rights of Richemont on the one hand, and the ISPs' freedom to carry on business and internet users' freedom to receive information on the other.

As well as allowing the operators of the infringing websites and the ISPs to apply to Court to discharge or vary the orders in the event of a material change of circumstances, the judge also introduced three additional safeguards:

"Such orders represent a potentially significant new tool in the brand owner's armoury"

- The orders should expressly permit affected ISP subscribers to apply to the Court to discharge and vary the orders;
- When a user attempted to access a blocked website, a message should appear identifying the party or parties which had obtained the blocking order and stating that the user had the right to apply to the Court to discharge or vary the order; and
- A"sunset clause", limiting the duration of the orders to a defined period, provisionally suggested to be two years.

While Richemont was ordered to bear the costs of the application, the cost of implementing the orders will be borne by the ISPs.

Impact

It remains to be seen whether the decision, which extends the Court's existing jurisdiction in respect of claims of copyright infringement to claims relating to allegations of trade mark infringement, will lead to a deluge of similar applications by other brand owners. Indeed, Richemont noted that these six websites represented the tip of the iceberg and that it was currently monitoring some 239,000 potentially infringing websites.

In any event, such orders represent a potentially significant new tool in the brand owner's armoury. Brand owners should nonetheless be aware that the costs of obtaining such blocking orders are likely to be significant, and they may therefore be advised to concentrate their resources and request blocking orders only in respect of websites that they believe are causing significant damage to their business.

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Managing supply chain risk

In recent years the Japanese earthquake, the Icelandic volcanic eruption and the horse meat scandal have all highlighted the reliance placed on suppliers and the dramatic impact a disruption to the supply chain can have on the performance and reputation of a business.

International issue, local problem

Modern supply chains are often exposed to international risks and the more complex a chain, the less predictable the disruption, and the more harm that disruption can cause. Recent studies confirm that the number of businesses involved in a typical supply chain is on the increase as is the dependency between businesses and their suppliers. In an increasingly global trading environment a disaster that takes place on the other side of the world can adversely affect a business as much as one that takes place on your doorstep.

What can businesses do to prepare?

The starting point is to analyse your suppliers. That means understanding not just your supply chain but also your supplier's supply chain. The importance of this is demonstrated by events following the Japanese earthquake that affected businesses across the world. Japan supplies nearly 60% of the global supply of silicon, which is used by manufacturers to produce semiconductor chips for electronics companies. As a result of the Japanese earthquake the supply rate fell and as a knock-on effect the production of semiconductor chips ground to a halt and the financial repercussions were felt by companies such as Apple and Sony, despite the fact they were not direct customers of the Japanese suppliers.

Identify critical risks

Once you have analysed your suppliers, you should identify the critical risks to the business, be they financial and/or reputational. Suppliers should be ranked in order of importance to the performance of the business by considering the potential issues each may face and how their failure (temporary or permanent) would affect the business. For example, are all key suppliers located in the same geographical area so that if a natural disaster affects one it would probably affect them all? In the aftermath of the Thai floods this was a problem for motor businesses that relied on the production of parts, which is concentrated in Thailand.

For other businesses, risks can be much harder to militate against and other forms of protection are required. For example, supermarkets suffered considerable reputational damage in the wake of the horse meat scandal last year, which was largely attributed to failures by their suppliers. The loss of reputation and urgent need to find alternative suppliers were serious risks to

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their business. In addition, emerging risks such as cyber-breach are becoming more common and these present particular issues for companies that have to entrust large volumes of sensitive data to their suppliers.

How to protect the business

Once a business has identified its key risks it needs to consider how best to address them. That can be through a number of options such as diversifying its supplier base or stockpiling key components. Where these steps are impractical or onerously expensive one way to fill the gap is through appropriate insurance. A suitable insurance programme will always form part of a business's risk management tools, but ensuring you get the most appropriate cover is not always that straightforward.

Most businesses are familiar with the traditional business interruption insurance cover which is linked to damage to the business's property and uptake of this type of insurance (referred to as PD/BI) is normally high. However, those policies often do not cover losses attributable to a failure by a supplier in the chain where the business itself has not suffered any physical damage. Where supplier cover is provided under traditional PD/BI cover it is subject to a low sub-limit, a hangover from the large losses suffered by insurers in the wake of the Thai floods.

Cover that does not require physical damage as a trigger is known as contingent business interruption insurance. The insurance industry is responding to rising demand and is increasingly offering products that cover losses that arise from both damage and non-damage. Innovative products are emerging and uptake is on the increase as businesses seek to protect themselves from risks over which they have limited control. Every business needs to review its current and recent supplier arrangements to ensure it is prepared for a disaster on its doorstep or thousands of miles away.

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Collateral warranties or third party rights: The story so far

Whether you are opening a store, fitting out your headquarters, or redeveloping a site for a distribution centre, the chances are that a collateral warranty will land on your desk. For those who have not previously been involved in development projects, this can be a puzzling document. Even for those experienced in large scale developments, several recent court decisions have put the spotlight on how collateral warranties might be used going forwards.

A collateral warranty is a contract, often between a building contractor, sub-contractor or a consultant and an interested third party, such as a purchaser of a property or a tenant creating a direct contractual link giving the third party an ability to sue the warrantor. It is 'collateral' to the contract entered into between, say, the original building owner and the contractor or consultant.

Why do we need them?

In the event that something goes wrong on a project, a third party may want to recover directly from the party that caused the problem (be that the architect who prepared a defective design or the contractor who installed faulty foundations).

The common law doctrine of privity of contract meant that third parties, such as funders, tenants or purchasers, would be unable to bring a contractual claim against the contractors or consultants who were at fault because they were not a party to the original contract of engagement.

The alternative of a negligence claim did not offer much comfort as the English law of tort is quite limited where the loss is purely financial. The construction industry looked to the law of contract for a solution and to date has commonly relied upon collateral warranties.

Is it all that simple?

Sadly, not always. Despite modern procurement practices and sophisticated project management, obtaining signed collateral warranties remains notoriously difficult, often taking weeks if not months to procure.

Traditional mechanisms such as making the provision of warranties a pre-condition to payment may be less useful where the works or services are complete or the warrantor has gone bust. So what is to be done if, despite requests, the warrantor fails to provide a collateral warranty which it is contractually obliged to provide?

Oakapple Homes (Glossop) Ltd v DTR (2009) Ltd is a recent case that shows that the remedy of specific performance will usually be available in such circumstances and may be ordered by the court to compel the warrantor to sign a warranty. Failure to comply with such a court order can amount to

"In the event that something goes wrong on a project, a third party may want to recover directly from the party that caused the problem."

contempt of court and attract penalties of imprisonment, fines and/or winding up in the case of companies.

In Liberty Mercian Ltd v Cuddy Engineering Ltd the Court went further. Despite the building contract having been terminated, the Court ordered the contractor to procure warranties from its insolvent consultant. As liquidation of the consultant had concluded, the contractor would have to apply to have the consultant restored to the Companies Register and then to commence its own court proceedings to compel the liquidator to execute the warranties. Central to the Court's reasoning was that the consultant may have had professional indemnity insurance which would respond to claims under the collateral warranties.

Both decisions will be welcomed by employers who can now have faith that obligations to provide collateral warranties will be robustly enforced. Contractors would be well advised to comply with their collateral warranty obligations at the outset of the project to avoid having to pursue reluctant warrantors (or their liquidators) at a later date.

Third party rights

The Contracts (Rights of Third Parties) Act 1999 was introduced sixteen years ago to reform third party rights and allow third parties to enforce contracts to which they were not a party. The Act had the potential to wipe out collateral warranties overnight but, until recently, construction contracts tended to exclude the rights under the Act. There was reluctance from the industry to move away from the familiar – people liked the comfort of a signed piece of paper.

However, the concept of third party rights in place of a warranty is now widely accepted as a simpler and less paper-heavy alternative. A contract will include a schedule of benefits given to a third party. Once the identity of the beneficiary is known, the employer or the contractor will give notice to the warrantor. The notice automatically confers the rights specified in the schedule on the third party without the need to obtain signatures. As the decisions in Oakapple Homes and Liberty Mercian show, this is a significant advantage that third party rights have over collateral warranties.

To those who are advocates of third party rights as an alternative to collateral warranties, the decisions are another reason to choose third party rights to avoid the costs and uncertainties of court proceedings.

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Competition risks in online selling

While government policies are geared at promoting online commerce, competition regulators are responding as competition law and policy plays catch-up. New business models may not fit neatly within traditional competition law approaches and both the European Commission and the UK's Competition and Markets Authority (CMA's) appear to have recognised this. The new European Commission, led by "digital president" Jean-Claude Juncker has identified fair competition in the digital economy of the EU as a "top priority".

The increase in competition and price transparency brought about by online commerce brings challenges. It is often in a brand owner's interests to have a high street presence but online channels often give rise to downward pressure on retail selling prices potentially jeopardising the existence of 'bricks and mortar' outlets. Manufacturers commonly want to support 'bricks and mortar' retailers, or structure their online and offline distribution channels separately, as well as imposing restrictions on sales channels to protect brand image. However, this can be at odds with competition law, and in some EU member states, we are seeing a particularly rigid approach to competition law enforcement to multi-channel distributions systems. This is causing difficulties in establishing pan-European distribution systems.

The approach of competition law

The approach taken under EU competition law is that, in principle, every distributor must be allowed to use the internet to sell products and must not be restricted from doing so, unless there are compelling reasons, such as health and safety concerns, not to do so. As with all distribution channels, manufacturers are not permitted to control retail selling prices. However, EU competition law does permit manufacturers to impose quality standards for online distribution, allows the use, in certain justified circumstances, of selective distribution systems and seemingly allows manufacturers to establish different strategies between different channels to reflect the variation in costs and commercial drivers.

A protective approach to online selling

Two recent UK cases in the mobility aids sector illustrate how enforcement is driven by the objective of facilitating online sales. The OFT (now CMA) issued an infringement decision in 2013 against Roma Medical Aids Limited, a manufacturer of mobility scooters. Roma's arrangements with online retailers involved two types of agreement the object of which was to restrict competition: prohibiting online sales and prohibiting online advertising of prices. The OFT argued that, as a result of the restrictions, consumers were limited in choice and in their ability to compare prices. In March 2014, the OFT announced a second (and similar) decision in relation to another supplier of mobility scooters (Pride Mobility Products Limited) where a supplier prohibited online advertising of prices below its own RRP. More cases are expected given the CMA's focus on online markets and the commencement in November 2014 of a large study into online commerce.

"European Commission guidance makes clear that an agreement that a distributor shall pay a higher price for products intended to be resold online…is a hard-core infringement."

Whilst many national competition authorities, such as those in France and Austria, have investigated online sales restrictions and whilst there are currently a number of investigations into the use of online hotel booking sites, of most concern is the position in Germany which has seen the highest level of enforcement. Recent cases in the last year have taken a hard line approach to the use of selective distribution systems and restrictions preventing the use of online marketplaces with Sennheiser, ASICS and Adidas all being found to have been guilty of imposing such restrictions. Dual pricing has also been an enforcement focus. European Commission guidance makes clear that an agreement that a distributor shall pay a higher price for products intended to be resold online than for products it intends to be resold offline is a hard-core infringement. However the EU position appears to allow different pricing structures to be offered to different types of distributor. The approach of the German competition authority takes a much stricter approach to this issue and considers that any obligations which have the effect of distinguishing between online and offline sales channels are prohibited. The German authorities do not appear to recognise the different cost structures of the two channels and as a result a number of brand owners, including luxury bathrooms manufactures, Dornbracht and garden products manufacturer Gardena, have been condemned for dual pricing between sales channels.

What next?

It is clear that across Europe online sales channels are now a key area of focus for competition regulators However, not all national authorities are taking a hard-line approach. The Netherlands' competition authority is such an example, considering that many vertical restraints do not have a material anti-competitive effect. As a result, divergent enforcement approaches are developing. Brand owners with pan-European distribution systems who sell online and offline are therefore recommended to keep a close eye on the developing case-law.

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