Combat grey market goods in the US

Case law surrounding grey market goods is still developing in the United States, but **Ronald Dove** and **Hope Hamilton** suggest some practical strategies for successfully preventing their importation and distribution

Grey market goods, also known as parallel imports, are genuine products protected by copyright, trade mark or patent rights that are imported into a country without the authority of the IP rights owner in that country. It is estimated that tens of billions of dollars are lost annually to grey market sales. The problem is exacerbated by the expanding and borderless internet marketplace and will almost certainly worsen as the global economy slips into recession. Notwithstanding this growing problem, a broad base of IP owners, including in the fields of luxury goods, information technology, publishing, software and pharmaceuticals, persist in their efforts to tackle the grey market, with notable success.

No grey skies for copyright

The past few months have yielded a series of decisions that have solidified the principle that the so-called first sale doctrine is not a defence to unauthorised importation and distribution of copyrighted grey market goods that are manufactured and first sold abroad. In September 2008, the US Court of Appeals for the Ninth Circuit affirmed its long standing precedent in this respect (*Omega SA v Costco Wholesale Corp* [9th Cir 2008]). This was the Ninth Circuit's first copyright case concerning grey market goods since the Supreme Court decided *Quality King Distributors, Inc v L'anza Research International, Inc* (1998). In that case, the Supreme Court held that the first sale defence under § 109(a) of the Copyright Act applied to copyrighted goods made in the United States, exported abroad, then imported back into the United States, and that the US copyright owner could not stop the sale of grey market goods under those circumstances. The Supreme Court did not reach the issue of whether the first sale defence would apply where the goods were manufactured abroad and then imported into the United States, a point that Justice Ginsberg took great care to emphasise in her concurring opinion.

The *Omega* decision is the first US federal appellate court opinion to directly address this issue left open by the Supreme Court in *Quality King*. Omega, a well-known watch manufacturer, filed suit against discount store Costco for infringing its distribution and importation rights under §§ 106(3) and 602(a) of the Copyright Act. Omega alleged that Costco was selling unauthorised, genuine Omega watches bearing Omega's US-copyrighted "Omega Globe Design". Costco responded that such sales were permitted under the first sale doctrine of § 109(a), which generally limits §§ 106(3) and 602(a) and states that once a copyright owner has sold a lawfully made copy, the purchaser "is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy".

After carefully analysing the Supreme Court's decision in *Quality King*, including Justice Ginsburg's concurrence, the Ninth Circuit concluded that the Supreme Court "did not address the effect of § 109(a) on claims involving unauthorised importation of copies made abroad". The Ninth Circuit went on to parse the language of the Copyright Act and to conclude that "the application of § 109(a) to foreign-made copies would impermissibly apply the Copyright Act extraterritorially in a way that the application of the statute after foreign sales does not". Thus, the Ninth Circuit upheld its established precedent, concluding that "the first sale doctrine is unavailable as a defense" and that Costco could be held liable for its unauthorised importation and sale of copyrighted Omega watches manufactured and first sold abroad. Costco has petitioned for rehearing *en banc*.

Microsoft Corporation has also had significant success in the past year combating grey market goods. Courts ruled in Microsoft's favour in at least three separate cases involving claims of unlawful importation and distribution of Microsoft's Student Media software that was manufactured abroad and not authorised for sale

One-minute read

So-called grey market goods are imported into a country without the consent of the IP rights owner and may be manufactured under poor conditions and without employing standard quality control measures. This can harm a company's reputation and result in substantial lost profits. Although US law is not yet developed when it comes to enforcing IP rights over grey market goods, recent copyright and trade mark case law offers hope for IP owners and can be instructive in considering strategies for diminishing the potentially negative impact of such products. By staying informed and employing these helpful practice tips, IP owners can avoid falling prey to the gloom often cast by grey goods.

or use in the United States. Most recently, in *Microsoft Corporation v Intrax Group, Inc*, No (ND Cal, 2008), the US District Court for the Northern District of California granted summary judgment in Microsoft's favour, citing the Ninth Circuit's recent decision in *Omega*, and rejecting the defendant's appeal to the first sale doctrine. The court also confirmed that a US purchaser or retailer of grey market goods can be found liable for copyright infringement even if it was not the original importer of those goods.

Look to the Lanham Act

Trade mark owners continue to find success in appealing to the US Lanham Act to fight grey market goods. In *Hyundai Construction Equipment USA, Inc v Chris Johnson Equipment, Inc*, (ND Ill, 2008), a federal court in Illinois granted summary judgment in favour of Hyundai, the exclusive distributor of new Korean manufactured Hyundai heavy construction equipment in the United States and Canada. Hyundai sought an injunction prohibiting Johnson, the defendant, from selling in the United States Hyundai equipment that was manufactured for sale in the Korean and Chinese markets. Johnson argued that Hyundai lacked standing because it did not own the Hyundai trade mark in the United States. He also asserted that there was no evidence of actual consumer confusion, because his buyers were sophisticated and knew that the equipment they were purchasing differed from that authorised for sale in the United States.

The court held that Hyundai had standing under § 43(a) of the Lanham Act, even though its parent owned the Hyundai trade mark in the United States, because it had a reasonable interest to protect against false advertising and the likelihood of consumer confusion, particularly where Johnson was benefiting from Hyundai's promotion of its products in the United States. The court went on to conclude that Johnson had infringed the Hyundai trade mark due to the likelihood of confusion caused by numerous "material differences" in the equipment, including that the unlawfully imported equipment had altered or defaced serial numbers, was sold without the standard warranty available in the US, had Korean language safety, operation, and maintenance instructions, and had non-EPA compliant engines.

Quality control

Employing strict quality control measures also has proven to be an effective tool in combating grey market goods. Although US courts have been inconsistent in their approach to considering quality control measures – some treat such measures as a factor in the "material difference" test, others treat them as

Tiffany v eBay

The recent decision in *Tiffany (NJ) Inc v eBay, Inc*, (SDNY, 2008) is also instructive for those battling the grey market.

Frustrated with the skyrocketing cost of tackling a seemingly endless stream of individuals selling counterfeit goods through eBay's online marketplace, Tiffany filed a suit against eBay under theories of direct and contributory trade mark infringement, unfair competition, false advertising and dilution. With regard to counterfeit sales, Tiffany argued that eBay was on notice of the illegal activities of its sellers and that by failing to pre-emptively prohibit listings of certain Tiffany items, eBay engaged in infringing activity. eBay countered that it was Tiffany's responsibility to police for counterfeits and report them to eBay – if Tiffany reported specific instances of infringement, eBay would promptly act to remove them. The US District Court for the Southern District of New York agreed with eBay and entered judgment in eBay's favour.

Although Tiffany has appealed this decision, the case is nevertheless instructive for those battling grey market goods for three reasons:

1) It serves to emphasise that courts may put the burden on IP owners to enforce their rights, even where there may be strong evidence that the "middleman" (such as auctioneers, flea market operators or ISPs) know or have reason to know of infringing activities by their customers.
2) The strength of Tiffany's arguments was diminished by its perceived failure to take sufficient steps and to invest sufficient resources toward combating infringement (for example Tiffany stopped using eBay's VeRO programme and invested less than 0.05% of its net sales in one year for brand enforcement).
3) Finally, the decision reinforces that IP owners may prevail on a contributory infringement theory against the "middleman" where the middleman (i) has direct control, (ii) exercises sufficient control and monitoring, and (iii) knows of specific instances of infringing activity and fails to take steps to prevent it.

Chase the grey away

It is important to develop a strategy for combating grey market goods that is most suitable for your needs. Factors that influence such strategies include the scope of the problem, budget, business relationships and the type of IP right underlying any claim. Specific considerations and strategies include:

- **Positioning your business for the greatest enforcement potential.** Maintaining trade mark registrations and properly registering copyrights is critical. Consideration should also be given to business relationships. The ability to enforce rights in the United States may be lost if licences and distribution agreements in other countries do not make clear that right owners, licensees and distributors in those countries are not authorised to export to or sell those products in the United States. Likewise, the US trade mark or copyright holder or its licensee must unambiguously have exclusive rights to sell in the United States.
- **Positioning your products for the greatest enforcement potential.** In the case of trade mark rights, consider instituting quality control standards and anti-counterfeiting systems that will allow trade mark owners to identify and distinguish between non-authorised goods (for example UPCs, serial numbers, batch codes, expiration dates, unique packaging for different markets, and use of secondary trade marks). Trade mark owners should also bear in mind that the threshold for "material" differences between authorised and non-authorised products is relatively low. In the case of copyrights, copyright owners will be most successful combating grey market goods where the goods are manufactured abroad and intended for sale abroad. But copyright claims only work where the products themselves are protected by copyright or contain packaging or labelling protected by copyright. If the design is not placed on the product or the packaging or other material important to the consumer, an importer may evade liability by simply bringing the goods into the US without the copyrighted elements or removing the copyrighted element prior to resale.
- **Utilising notice-and-take-down procedures.** Most established marketplace websites, including eBay and Amazon, have procedures in place through which IP owners can submit notice-and-take down requests to remove infringing grey market listings from such websites.
- **Identifying the target.** Identifying and tackling repeat infringers often yields the greatest success in short order. In some instances, however, companies may wish to investigate suppliers, wholesalers, foreign distributors, Internet ISPs, and other entities in the chain in an attempt to tackle the problem at its source.

a separate consideration in assessing the genuineness of a good (that is goods that do not meet the trade mark owner's quality control standards are not considered genuine) -courts have consistently found them to be relevant in their analysis of grey goods cases.

The US District Court for the Southern District of New York recently faced the task of determining whether "anti-counterfeiting systems constitute a 'quality control procedure' as protected by the Lanham Act" (*Zino Davidoff SA v CVS Corporation* [SDNY, 2007]). The grey market goods in that case were "decoded" Davidoff goods whose unique product code (UPC) code numbers had been removed by various methods, including cutting away portions of the packaging, grinding the bottom of bottles, and using chemicals to wipe away labelling.

Davidoff argued that the removal of the UPCs affected its quality control procedures because it (1) restricted Davidoff's ability to identify and remove counterfeit goods, (2) undermined its ability to identify, inspect and recall products, and (3) limited its anti-theft systems. The court reserved judgment on the anti-theft system argument, but concluded that Davidoff's anti-counterfeiting system is a "species of quality control protected under the Lanham Act" where it serves to prevent the infiltration of counterfeit goods that undermine the central goals of the Lanham Act, and serves as a "sufficiently legitimate, substantial, and nonpretextual" quality control system that allowed Davidoff to quickly "identify and rectify possible quality issues" with its products. Concluding that Davidoff had shown a likelihood of consumer confusion and that irreparable harm would result from sales of decoded Davidoff products, the court granted Davidoff's motion to preliminary enjoin retailer CVS from selling such products.

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Practice tips

While US law concerning grey market goods is continuing to develop, particularly with respect to internet-related sales, the strategies available to IP owners are relatively clear. First, it is important to understand the scope of the problem. Regular due diligence and investigation is central to protecting any IP right. Investigative firms can assist with storefront counterfeit and grey market goods sales. In recent years, a few companies and law firms have developed sophisticated internet investigation groups, which employ both human resources and technical tools to crawl the internet in search of counterfeit and grey market goods.

It is also imperative to be aware of your enforcement options. In addition to notice-and-take down procedures, cease-and-desist letters and pursuing claims in federal courts, trade mark owners can under certain circumstances register their marks with Customs to prevent the unlawful importation of grey market goods or litigate their claims before the International Trade Commission, seeking an exclusion order directing Customs to prevent the unlawful importation of such goods.

Another option is to consider building coalitions. The struggle to combat grey market goods is common to many, and the particular interests and challenges facing businesses in similar markets can be identical.

Finally, educate consumers and potential infringers about what constitutes illegal conduct, including by publicising successful enforcement efforts. Such publicity may affect infringers as they weigh the risks and benefits of their activities. Stay informed of developments in the case law and of the new and evolving tools to combat the importation and sale of grey market goods.


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