United States: Owners Prevail Over Altered and Decoded Goods

by Charles E Buffon, Ronald G Dove Jr and Marney L Cheek

2001 was a good year for US trademark owners seeking to stem the flow of demarked and decoded goods in the United States. Two key court decisions focused on and attempted to remedy the harms caused by the common practice of removing product codes and other markings from diverted goods in order to prevent identification of diverters and to evade border enforcement and other controls put in place by the trademark owner.

In *Davidoff & CIE, SA* v *PLD International Corp*, 263 F.3d 1297 (11th Cir. 2001), the United States Court of Appeals for the Eleventh Circuit affirmed a nationwide preliminary injunction against the sale of decoded fragrance products on the theory that the sale of such "materially different" products constituted trademark infringement. The appeals court found that the small scar near the bottom of the backside of each fragrance bottle caused by the removal of the batch code degraded the appearance of the product and made it likely that consumers would believe that the product had been tampered with. Significantly, the court refused to limit its ruling to grey market goods imported from outside the United States, holding that the resale of any trademarked product "that has been altered, resulting in physical differences in the product, can create a likelihood of consumer confusion" and give rise to a trademark infringement claim.

The Eleventh Circuit's decision came on the heels of an opinion issued earlier in the year, *Montblanc-Simplo GmbH* v *Staples Inc*, No. 01-10235-DPW, 2001 U.S. Dist. LEXIS 7905 (D. Mass. May 3, 2001), in which a federal court in Boston entered a nationwide preliminary injunction barring Staples, the office supply superstore chain, from selling MONTBLANC writing instruments from which identifying serial numbers and a secondary trademark, PIX, had been removed[1]. The *Montblanc* court entered the injunction after concluding that differences in appearance, physical integrity and quality control between the decoded and demarked pens sold by Staples and the genuine MONTBLANC products sold by Montblanc's authorised dealers were material, and therefore Montblanc was likely to prevail on the merits of its trademark infringement claim against Staples.

Both the *Davidoff* and *Montblanc* cases have significant implications for trademark holders seeking to reduce the unauthorised distribution of their products in the United States. By strategically placing product codes and other markings on their products, trademark owners can create a difficult and costly dilemma for traffickers in diverted merchandise: If the codes and markings remain on the product, the goods can be tracked or stopped at the border; if, alternatively, the codes and markings are removed in a way that defaces the product, the trademark owner may be able to obtain relief from US courts.[2]

Product decoding sparks litigation

The *Davidoff* and *Montblanc* cases both involved the sale of altered and decoded products outside the chain of authorised distribution. The decoding process — usually involving an etching tool that scratches off the batch code, serial number, and/or other identifying mark on the product — creates physical differences between the diverted products and the genuine goods. Although the decoded goods still bear the primary registered marks of the trademark owner, the decoding process typically damages the appearance, physical integrity and/or composition of the product, and can hamper quality control as well.

Davidoff, a manufacturer of luxury fragrance products and the owner of the DAVIDOFF COOL WATER mark, entered into an exclusive distribution agreement with Lancaster Group, authorising Lancaster to distribute DAVIDOFF COOL WATER products to select retail outlets in the United States. PLD International acquired DAVIDOFF fragrance products and distributed them in the United States without Davidoff's or Lancaster's authorisation. PLD or a third party used an etching tool to remove the batch code on each bottle, leaving a scar on the bottle's surface. PLD admitted that the batch codes were removed to prevent Davidoff from tracking the distribution of DAVIDOFF products and determining which Davidoff vendors were selling to unauthorised retailers.

Davidoff sued PLD for trademark infringement in federal court in Miami and moved for a preliminary injunction. The district court granted Davidoff's motion after concluding that it was likely to succeed on the merits of its trademark infringement claim because the sale of materially altered DAVIDOFF COOL WATER products created a likelihood of consumer confusion. The Eleventh Circuit, in a case of first impression, affirmed the lower court's ruling.

The *Montblanc* case arose under similar factual circumstances. Montblanc, the owner of the MONTBLANC mark, has an exclusive distribution arrangement in the United States and chooses to distribute its MONTBLANC writing instruments solely through authorised Montblanc dealers. Montblanc restricts sales to retail establishments that, in its judgment, enhance the image of MONTBLANC products by providing a high-quality product environment, trained sales associates and on-site media advertising and promotion of MONTBLANC products.

Staples, the office supply superstore and an unauthorised retailer of MONTBLANC writing instruments, obtained altered MONTBLANC writing instruments from a third party. The altered writing instruments sold by Staples were different from genuine MONTBLANC products. The serial numbers and a secondary trademark, PIX, had been removed from the writing instruments with an etching tool, leaving behind visible scars. The markings were removed to prevent Montblanc from tracing the source of the product and to evade border enforcement of the PIX trademark by the US Customs Service.

Montblanc moved for a preliminary injunction against Staples on the theory that these altered writing instruments were materially different from genuine MONTBLANC products and were likely to cause consumer confusion in violation of federal trademark law. The district court in Boston agreed, crediting evidence submitted by Montblanc that in addition to degrading the product's physical appearance, the demarking process compromised product integrity and increased the likelihood of corrosion. The court also found that removal of the serial numbers made it more difficult for Montblanc to control the quality of its products. In the face of these material differences, the *Montblanc* court issued a preliminary injunction barring the sale of altered *MONTBLANC* writing instruments.[3]

"Material differences" confuse consumers and injure goodwill

The Lanham Act prohibits the unauthorised use in commerce of a registered trademark when such use "is likely to cause confusion, or to cause mistake, or to deceive" 15 U.S.C. §§ 1114(1)(a), 1125(a)(1). Generally speaking, a trademark owner exhausts its right to maintain control over the resale of a particular product once it introduces that product into the stream of commerce. However, there is an important and significant exception to this "first sale" doctrine. As the *Davidoff* court held, "when an alleged infringer sells trademarked goods that are materially different than those sold by the trademark owner, . . . [the] materially different product is not genuine and therefore its unauthorized sale constitutes trademark infringement" *Davidoff*, 263 F.3d at 1302. This "material difference" exception has been adopted by every federal appellate court to have considered it, including the First, Second, Third, Fifth, Ninth, Eleventh, and Federal Circuits.[5]

The *Davidoff* court expressly rejected the argument that the material difference exception only applies to grey market goods, ie, foreign-made goods intended for sale abroad, but subsequently imported into the United States without the consent of the US trademark holder. The court found that the unauthorised purchase and resale of goods solely within the US may also constitute infringement when the domestically diverted goods have been so altered as to become materially different from those sold by authorised dealers.

The sale of materially altered goods violates the federal Lanham Act because the resale of a trademarked product that differs from a genuine product "may confuse consumers and erode consumer goodwill toward the mark" *Davidoff*, 263 F.3d at 1302. As the *Montblanc* court explained, and the Davidoff court confirmed, "the mere showing of a material difference between goods simultaneously sold in the same market under the same name creates a presumption of consumer confusion as a matter of law" *Montblanc*, 2001 U.S. Dist. LEXIS 7905, at *13-14 (*quoting Societe des Produits Nestle SA* v *Casa Helvetia Inc*, 982 F.2d 633, 641 (1st Cir. 1992) (*Nestle*)); see also *Davidoff*, 263 F.3d at 1302-03.

The "material difference" exception is grounded in the two fundamental purposes of trademark law: to protect consumers and to protect trademark owners. As the Eleventh Circuit observed, "[c]onsumers who purchase a particular product expect to receive the same special characteristics every time. The Lanham Act protects these expectations by excluding others from using a particular mark and making consumers confident that they can purchase brands without being confused or misled" *Davidoff*, 263 F.3d at 1301.

Both the *Davidoff* and *Montblanc* courts also explicitly recognised that trademark owners invest considerable time, energy and money to build a positive reputation for their products. The "material difference" exception gives trademark owners a means of protecting this investment by preventing the erosion of goodwill that would otherwise result from the sale of altered and decoded goods.

Even subtle differences may be material

A material difference is "any difference between the registrant's product and the allegedly infringing [product] that consumers would likely consider to be relevant" when making a purchase *Montblanc*, 2001 U.S. Dist. LEXIS 7905, *14 (quoting *Nestle*, 982 F.2d at 641). This standard encompasses a broad range of consumer concerns — from visibly defaced products to the manufacturer's ability to recall a product due to latent defects.

The differences between the genuine and altered goods need not be dramatic — indeed, quite the opposite is true. In *Davidoff*, the Eleventh Circuit concluded that "the threshold of materiality must be kept low to include even subtle differences between products" since subtle differences most easily confuse consumers *Davidoff*, 263 F.3d at 1302. The scars caused by the removal of product codes on the DAVIDOFF COOL WATER bottles were fairly small (one-eighth of an inch in length and one-eighth of an inch wide), visible only upon close examination, and were located on the backside of the bottle near the base. Nevertheless, the appeals court affirmed the lower court's determination that these scars were enough to constitute a material difference that could adversely affect Davidoff's goodwill and cause consumer confusion. The court agreed with the district court that the scars degraded the appearance of the product and that consumers might think that the product had been harmed or tampered with.[4]

The *Montblanc* court, citing the First Circuit's decision in Nestle, similarly observed that a low threshold of materiality is appropriate because "differences that are not blatant enough to make it obvious to the average consumer that the origin of the product differs from his or her expectations" are the differences that are most likely to confuse consumers *Montblanc*, 2001 U.S. Dist. LEXIS 7905, 14 (quoting Nestle, 982 F.2d at 641)). The district court found that there were several such differences between the genuine and grey market MONTBLANC writing instruments at issue and that those differences — when viewed in the aggregate — were likely to cause consumer confusion. As discussed above, those differences included the physical appearance of the products, their susceptibility to corrosion, and the manufacturer's ability to control the quality of goods bearing its registered marks. The fact that MONTBLANC writing instruments are luxury goods often given as gifts made these subtle differences especially relevant and more likely to mislead consumers and damage Montblanc's reputation.

Packaging is part of the product

A product's packaging can be an integral part of the product itself for purposes of evaluating a trademark infringement claim. As the *Davidoff* court recognised, "a vendor is not only selling the product inside the bottle, it is also selling the 'commercial magnetism' of the trademark that is affixed to the bottle... The appearance of the product, which is associated with the trademark, is important to establishing this image" *Davidoff*, 263 F.3d at 1303-04. For this reason, the appeals court held that the bottle itself was material to a consumer's decision to purchase DAVIDOFF COOL WATER products. Even though the chemical composition of the fragrance was allegedly the same in both the genuine and decoded bottles, the difference in the packaging constituted a material difference likely to cause consumer confusion.

Notices and disclaimers

The court in the *Montblanc* case also rejected notices and disclaimers as a means of avoiding consumer confusion where the products at issue are materially different. Staples argued that a sign it placed in each store and a sticker placed on the bottom of each pen box dispelled any possible consumer confusion. The *Montblanc* court rejected this argument, finding that Staples had not met its burden of showing that these disclosures significantly reduced the risk of confusion either to purchasers at the point of sale or to gift recipients after the sale. While recognising that in some instances the provision of adequate notice can obviate consumer confusion, the court held that the "[n]otices provided by Staples only at the point-of-sale and on the pen case rather than on the actual product will be of little help in avoiding consumer confusion in the post-sales context. Individuals who receive the altered pens as gifts or who see the pens being used by the actual purchasers may be unimpressed with the quality of Montblanc products and consequently decide not to purchase genuine unaltered Montblanc products"[6] *Montblanc*, 2001 U.S. Dist. LEXIS 7905, *34-35.

Conclusion

The recent *Davidoff* and *Montblanc* decisions make it more difficult for diverters and their customers to decode and sell products that bear prominently placed product codes or trademarks that qualify for border enforcement.[7] If diverters cannot remove batch codes, serial numbers, and border-enforceable trademarks without materially altering the product, they will be forced to leave the identifying numbers and enforceable marks intact or risk court action. If the numbers and marks are left intact, trademark owners will be able to detect which vendors are selling to unauthorised retailers and cease dealing with those vendors, or, in some instances, prevent such products from entering the United States altogether by means of a trademark enforcement programme coordinated with the US Customs Service. The *Davidoff* case is particularly significant in that the Eleventh Circuit territory in which it is binding includes Florida — historically a hotbed of grey market importation and diversion activity.

© Charles E Buffon, Ronald G Dove Jr and Marney L Cheek 2002. The authors are attorneys at the law firm of Covington & Burling (www.cov.com) and serve as counsel to the prevailing parties in the Davidoff and Montblanc cases discussed in this article. Additional information about the various strategies for combating the sale of grey market and domestically diverted goods can be obtained by contacting the authors at cbuffon@cov.com or rdove@cov.com.

1 Staples ultimately agreed to entry of a permanent injunction against it, as did another superstore, OfficeMax, in a companion lawsuit filed in federal court in Cleveland.

2 While not the focus of this article, another recent case suggests that in certain circumstances trademark owners may also be able to bring a claim against unauthorised retailers for intentional interference with contractual relations. In *Sebastian International, Inc.* v *Russolillo*, 162 F. Supp.2d 1198 (C.D. Cal. 2001), Sebastian, a manufacturer and distributor of hair care products, notified defendants that Sebastian's contracts with its authorised distributors restricted the sale of Sebastian products to salons only. A federal court in California denied summary judgment to the defendant unauthorised retailers because they had notice of the terms of Sebastian's distribution contracts and arguably "knew with at least substantial certainty that a necessary consequence of their actions would be that Sebastian's performance of [its] contractual relations with distributors and salons would be made more expensive or burdensome." Although such a broad definition of disrupted contractual relations does not exist in every state, *Sebastian* provides trademark owners with yet another potential option for combating diversion and protecting the goodwill associated with their marks.

3 The court imposed an absolute bar on the sale of MONTBLANC writing

instruments with both the serial number and PIX mark removed from the exterior gold rings. With respect to the sale of other altered MONTBLANC writing instruments, the court barred their sale unless the notice placards and outer box stickers accompanying them were modified and a special notice was stamped on the hard case containing the writing instrument.

4 *See, eg, Societe Des Produits Nestle, S.A.* v *Casa Helvetia, Inc.*, 982 F.2d 633 (1st Cir. 1992) (reversing district court judgment and remanding for entry of injunction against the distribution and sale of materially different trademarked goods); *Original Appalachian Artworks, Inc.* v *Granada Elecs., Inc.*, 816 F.2d 68 (2d Cir. 1987) (finding trademarked goods not "genuine" because they were materially different from goods authorised for sale in the United States); *Iberia Foods Corp.* v *Romeo*, 150 F.3d 298 (3d Cir. 1998) (adopting "material differences" test but concluding that evidence was insufficient to establish trademark infringement); *Martin's Herend Imports, Inc.* v *Diamond & Gem Trading USA, Co.*, 112 F.3d 1296 (5th Cir. 1997) (affirming injunction against importation of materially different trademarked goods); *Intel Corp.* v *Terabyte Int'l, Inc.*, 6 F.3d 614 (9th Cir. 1993) (finding trademarked goods to be "counterfeit" because they were materially modified in a way that deceived consumers); *Davidoff & CIE, S.A.* v *PLD International Corp.*, 263 F.3d 1297 (11th Cir. 2001) (affirming injunction against sale of decoded, materially different trademarked goods); *Gamut Trading Co.* v *U.S. Int'l Trade Comm'n*, 200 F.3d 775 (Fed. Cir. 1999) (affirming exclusion order against importation of materially different trademarked goods).

5 While the *Davidoff* court recognised that "the lack of quality control can rise to the level of a material difference," it held that it did not need to address that issue given the physical differences between the products and the likelihood of confusion that those differences caused. *Davidoff*, 263 F.3d at 1300 n.4.

6 While the court completely banned the sale of the most severely altered pens, it did permit the sale of certain other altered pens under tight restrictions, among them that the following text be stamped in at least 10-point type on the hard case holding the writing instrument: "This MONTBLANC writing instrument has been altered and demarked. Montblanc will not honor any warranty for this writing instrument." *Montblanc*, No. 01-10235-DPW, slip op. at 3 (D. Mass. May 3, 2001) (Preliminary Injunction Order).

7 Many primary trademarks do not qualify for border enforcement because the US and foreign trademark owners are the same entity or are corporate affiliates of one another. *See K Mart Corp.* v *Cartier, Inc.*, 486 U.S. 281 (1988) (upholding Customs Service regulation denying border protection in such circumstances). For this reason, a company may choose to place a "secondary" trademark on its products (eg, Montblanc's PIX mark) that is owned outside the US by an entity not affiliated with the US trademark owner, and thus is entitled to border protection from the U.S. Customs Service. *See, eg, US* v *Eighty-Three Rolex Watches*, 992 F.2d 508 (5th Cir. 1993).