INTA Bulletin
The Voice of the International Trademark Association
October 1, 2010 Vol. 65 No. 17

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Best Practices for Preventing Sales of Gray Market Goods in the United States

As more and more companies expand their global footprint, distribution channels and pathways for goods become increasingly difficult for brand owners to control. Further, because of differing regulatory schemes, environmental conditions and consumer preferences in various countries, goods sold by a brand owner in one country may differ in formulation, packaging, warranties and quality control from those in other countries. These factors as well as the fluctuating currency values around the world can create a "perfect storm" that can result in the unauthorized sales of gray market goods. Such sales can be incredibly damaging to brand owners, as they erode goodwill in a brand as well as damage a brand owner's business relationships with authorized distributors, who now have to compete with sales of unauthorized gray market goods.

There are, however, a number of strategies and best practices that brand owners can employ to prevent the sales of gray market goods and enforce their rights against entities that are selling gray market goods. Specifically, in the United States, the sale and distribution of gray market goods that are "materially different" from goods authorized for sale in the United States constitute trademark infringement. Additionally, various courts have held that the sale and distribution in the United States of goods manufactured and first sold abroad that feature copyrightable subject matter can constitute copyright infringement. Although numerous courts have held that the first sale doctrine does not extinguish a copyright owner's ability to prevent the importation of gray market goods first manufactured and sold abroad, the Supreme Court has granted certiorari in *Costco Wholesale Corp. v. Omega, S.A.* to address this very issue (541 F.3d 982 (9th Cir. 2008), *cert. granted*, No. 08-1423 (Apr. 19, 2010)).

Thus, by strategically employing the trademark and copyright laws as well as using certain business approaches, brand owners can successfully impede the flow of unauthorized gray market goods into the United States.

Protect Your Property

Brand owners should identify and register both trademarks and copyrights featured on their products as part of their overall gray market enforcement. Thus, it is important for brand owners to examine the goods they sell, including packaging and accompanying materials, and to catalog what trademarks and copyrights are associated with their products. Additionally, with respect to potentially copyrightable subject matter, brand owners should focus on copyrightable subject matter appearing on the unauthorized gray market goods entering the United States, as well as consider whether elements of their trade dress could potentially be subject to copyright protection in addition to trademark protection.

Besides federal registration, brand owners should take advantage of the trademark recordal system available through U.S. Customs and Border Protection (Customs) and record their trademark registrations with Customs. Where appropriate, they should also consider seeking relief against the importation of gray market goods by applying for Lever Rule protection. Lever Rule protection is available for brand owners that are able to identify physical and material differences between the authorized goods and the gray market goods entering the United States. Although a simple recordal will not result in Customs stopping gray market goods (unless the U.S. trademark owner is unaffiliated with the foreign trademark owner), Customs will stop gray market goods if Lever Rule protection is granted.

One loophole to this system, however, is that if the importer applies a label to the product or packaging stating that "This product is not a product authorized by the United States trademark owner for importation and is physically and materially different from the authorized product," the goods will be released for entry. While such overlabel exception does undermine the effectiveness of Lever Rule protection, if the brand owner subsequently initiates infringement proceedings against the importer or seller of those goods, the application of such label could serve as an admission by the distributor or seller that the goods are materially different and thus constitute trademark infringement.

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Practice What You Preach

A requirement for establishing gray market trademark infringement is showing that the unauthorized gray market goods are materially different from the goods authorized for sale in the United States. Courts have consistently held that there is a low threshold for establishing material difference, but brand owners should be sensitive to the fact that courts are reluctant to find a particular difference to be material if the trademark owner has sold authorized goods in the United States featuring that same material difference or if entities within the control of the trademark owner have participated in gray market activity.

Thus, for example, if a trademark owner alleges that the gray market goods lack certain quality control measures or warranty protections, the trademark owner must be able to establish that substantially all of its authorized goods are accompanied by the quality control measures or warranty protections that are alleged to be missing from the gray market goods. Similarly, if dealers within the trademark owner's control have contributed to gray market activity in the United States, such activity could have an adverse impact on the trademark owner's ability to prevent the sales of gray market goods in the country. For instance, if entities within the control of the trademark owner are selling goods abroad that could be purchased, for example, online by U.S. customers, and such goods are materially different from goods authorized for sale in the United States, such sales could undermine the trademark owner's ability to prevent gray market sales in the United States.

Go to the Source

Because gray market activity is opportunistic and sporadic, collecting information on the source of the gray market activity, including activity originating outside the United States, is critical to effectively combating gray market sales in the United States.

Brand owners can rely on both internal and external sources to collect such information. With respect to internal sources, brand owners should tap into existing resources such as their sales personnel to collect and track information on gray market activity in the United States. Further, sales personnel should be given guidelines on the type of information to collect and track—for example, where the products at issue are coming from, importer information where available, and the material differences of the products. Additionally, where possible, brand owners in the United States should coordinate their efforts with related entities outside the country to identify entities suspected of exporting gray market goods to the United States. Brand owners can also turn to external vendors, which collect shipping information that can be useful in identifying importers engaged in gray market sales. Specifically, shipping information identifies the importers, consignees, volume and value of the goods, ports of entry and originating port and provides a description of the goods. While this information often can have errors or missing data, it is an additional resource for brand owners.

Also, because gray market goods are often sold to multiple parties and are quickly dispersed once they enter the United States, brand owners may consider using contractual provisions, subject to antitrust/competition restrictions in respective jurisdictions, to impede the exportation of gray market goods into the United States.

Enforce Your Rights and Publicize Your Efforts

Once brand owners have identified gray market activity in the United States, they should take action to enforce their rights. There are a number of enforcement options available to brand owners, including cease and desist letters, reporting activity to Customs (if Lever Rule protection has been obtained), initiating district court actions and instituting a Section 337 proceeding at the International Trade Commission (ITC). A Section 337 proceeding, while similar in many respects to district court action, has some significant differences. For example, such a proceeding is an investigation instituted by the ITC, and while the parties may engage in discovery and an evidentiary hearing, the ITC, unlike a district court, cannot award damages. However, the ITC does have the authority to issue powerful relief in the form of a general exclusion order, which can bar the importation of all infringing goods irrespective of the particular party importing the goods. Whether resolving a matter through cease and desist efforts or through litigation, brand owners should use negotiations and/or discovery to obtain as much information on the source of the products.

Additionally, when brand owners successfully enforce their rights, they should publicize their efforts through press releases and media coverage, as well as more informally through targeted sales communications. Entities importing gray market goods often deal in various types of goods, not just those emanating from a single brand owner. Thus, if such entities perceive significantly higher risks associated with importing a particular type of good, they may be inclined to stay away from those products in favor of others. Utilizing a robust communication strategy can be an effective mechanism for educating the gray market community on the risks associated with trading in a brand owner's goods.

Conclusion

Because of the nature of gray market activity with numerous suppliers and a lengthy supply chain, brand owners seeking to prevent such activity in the United States should employ a multipronged strategy in order to prevent gray market sales in the United States. By collecting information on the scope of their problem, prioritizing internal and external resources and strategically targeting particular offending entities, brand owners can comprehensively approach and address infringing gray market activity in the United States.

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