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UNAUTHORIZED ONLINE DEALERS OF "GENUINE" PRODUCTS IN THE AMAZON MARKETPLACE AND BEYOND: REMEDIES FOR BRAND OWNERS

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The growth of the internet as an online marketplace has created not only many new opportunities for companies to sell their goods or services, but also poses many new challenges to companies seeking to protect their intellectual property rights. As many companies know far too well, online sellers (some authorized by the manufacturer; many more not authorized) now have low-cost, direct access to consumers through their own websites and through online sites such as the Amazon Marketplace on amazon.com. This has led to a tsunami of online dealers infringing intellectual property rights. Pick any product you like of a well-known brand on amazon.com, especially of a high-end nature. Below the initial product description of features will be a link which says "33 new" or with some other number. Clicking that link brings you to a host of dealers -- authorized or not -- selling that product at prices below the list price.

While many products sold by unauthorized online retailers are counterfeits, some sell product actually manufactured by and for the trademark owner. The sale by unauthorized dealers of "genuine" goods poses the greatest legal challenge to makers of well-known brands.

Unauthorized dealers obtain the products they sell as "new" and "genuine" in a variety of ways. The dealers may purchase their goods from overseas markets where prices are lower than in the United States, then import them into the U.S. as "gray market" goods. They may buy the products cheaply in clearance sales or returns from authorized dealers in the United States. The goods may also have been transshipped by an authorized dealer to another for resale, in

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contravention of the distribution contract. The goods may simply have been stolen from the brand owner's normal distribution channels.

Such unauthorized dealers compete unfairly in a sense. They are essentially "free riders." They have minimal overhead and do not invest significantly in customer service, showrooms, quality, or advertising expense. Nevertheless, unauthorized dealers reap the benefits of such efforts. They trade off the brand owner's hard-earned reputation for quality and customer service. Not having the same overhead, they can undercut authorized dealers on price, driving prices down with their unfair advantage and making it difficult for authorized dealers (and ultimately the brand owner itself) to make a profit. It is this differential in service and quality of promotion and quality inherent in a system of authorized dealerships which needs to be protected.

That would be a minor issue perhaps if the volume of sales were small. But they are not. The Amazon Marketplace, as one example, is a massive conduit of sales of unauthorized products.

Brand owners are not without legal recourse against unauthorized dealers, however. Warranties are on the front line. Company warranties should expressly warn consumers that purchases from unauthorized dealers, even of otherwise "new" products from the company, voids warranty protection. Aside from giving a benefit to customers who buy from preferred dealers, it provides an important trademark/copyright infringement weapon as discussed below.

So, adopt a firm warranty policy. Next, publish it on the company website, listing *authorized* dealers for self-verification purposes. Examples are common with any company struggling with unauthorized dealers.[2] Other steps to mark genuine products may be considered.

I. TRADEMARK INFRINGEMENT AND UNAUTHORIZED SALES

Trademark infringement is the principal weapon brand owners have in combating unauthorized dealers. Without more, however, there is nothing improper about selling genuine product by an unauthorized dealer, insofar as trademark or other law is concerned. The first sale doctrine in both trademark and copyright law bars the brand owner from controlling the downstream sales. But trademark infringement can still arise regardless of the first sale doctrine.

1. <u>The First Sale Doctrine</u>

The first sale doctrine provides that one who purchases a branded item generally has a right to resell that item in an unchanged state. *See, Dan-Foam A/S v. Brand Named Beds, LLC,* 500 F.Supp.2d 296, 317 (S.D.N.Y. 2007). The trademark rights of a brand owner are "exhausted" once the particular item has been sold in the market. *Id*. But there are two exceptions to the first sale doctrine that may apply in the context of unauthorized online dealers. Those exceptions are the "material difference" exception and "quality control" exception.

2. <u>Fighting Back: Material Difference Exceptions</u>

[2] See, e.g., www.monsterproducts.com/warranty; www.klipsch.com/unauthorized; www.hoover.com/authorized-dealer.

The first sale doctrine does not protect alleged infringers that sell trademarked goods that are "materially different" than those sold by the trademark owner or its authorized dealers. This is so at least where there is a difference in the product or its warranties. In some jurisdictions, moreover, a difference in quality control measures can constitute trademark infringement of otherwise "genuine" goods under the owner's mark.

a. <u>The "Physical/Warranty Difference" Exception</u>

The existence of a material difference between authorized and unauthorized goods sold under the same trademark creates "confusion over the source of the product and result in loss of [the trademark owner's] good will." *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, 816 F.2d 68, 73 (2d Cir. N.Y. 1987). In other words, materially different goods sold by an unauthorized seller are not considered "genuine" because they are "confusingly different."

In applying this exception, courts define "material difference" broadly: it is virtually any difference that exists between the authorized goods and unauthorized goods, if a consumer would likely consider it relevant when purchasing the product. Courts have acknowledged subtle differences to be significant. As one court put it, "it is by subtle differences that consumers are most easily confused," and therefore "the threshold of materiality must be kept low enough to take account of potentially confusing differences -- 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." *Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc*., 982 F.2d 633, 641 (1st Cir. 1992).

Material differences may include either physical or non-physical differences between authorized and unauthorized goods. Physical differences that have been found to be "material" include: (a) differences in battery life between authorized and unauthorized batteries (*Duracell, Inc. v. Global Imports, Inc.*, 12 U.S.P.Q.2d 1651 (S.D.N.Y. 1989)); (b) differences in the variety, presentation, and composition of chocolates sold by authorized and unauthorized sellers (*Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.*, 982 F.2d 633 (1st Cir. 1992)); (c) differences in the formulation, content and tobacco blends of cigarettes (*R.J. Reynolds Tobacco Co. v. Premium Tobacco Stores, Inc.*, 71 U.S.P.Q.2d1670); (d) alterations to packages such as removal of reference numbers, SKUs, bar codes, and batch codes (*Davidoff & Cie, S.A. v. PLD Int'l Corp*., 263 F.3d 1297 (11th Cir. 2001)); (e) differences in package shape and labels (*Lever Bros. v. United States*, 877 F.2d 101 (D.C.Cir. 1989)); and (f) lack of Surgeon General's warning labels on cigarettes imported into the U.S. (*In the Matter of Certain Cigarettes and Packaging Thereof*, United States International Trade Commission, Inv. No. 337 -TA-643(October 1, 2009)).

Non-physical differences considered "material" include: (a) differences in warning and safety labels, operator manuals and service plans (*Bordeau Bros. v. ITC*, 444 F.3d 1317 (Fed.Cir. 2006)); (b) differences in warranty protection applicable (*Fender Musical Instr. Corp. v. Unlimited Music Center, Inc.*, 35 U.S.P.Q.2d 1053 (D.Conn. 1995) (material difference where Japanese-made guitars sold by unauthorized dealer were not covered by valid warranty)); and (c) differences in available services for authorized versus unauthorized goods (*Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, 816 F.2d 68, 73 (2d Cir. 1987) (Cabbage Patch dolls made for foreign market "materially different" where processing center in U.S. could not provide birthday cards to children who purchased dolls with Spanish-language birth certificates)).

b. The "Quality Control" Exception

Another exception to the first sale doctrine is the "quality control" exception, which has particular traction within the jurisdiction of the Second Circuit Court of Appeals. That exception stems from the premise that, "[o]ne of the most valuable and important protections afforded" to a trademark holder under federal law "is the right to control the quality of the goods manufactured and sold under the holder's trademark." *El Greco Leather Prods. Co. v. Shoe World, Inc.*, 806 F.2d 392, 395 (2nd Cir. 1986); see also *Warner-Lambert Co. v. Northside Dev. Corp.*, 86 F.3d 3, 6 (2nd Cir. 1996). For other jurisdictions, specific research is needed to determine the applicability of this standard. See, e.g., *Hunting World, Inc. v. Reboans, Inc.*, 1992 U.S. Dist. Lexis 17880 (ND Cal. 1992) (quality control an adequate basis).

Where applicable, differences in quality control standards can create a likelihood of confusion sufficient to support a claim for trademark infringement. The rationale for this rule is that the sale of goods that do not conform to the trademark owner's quality control standards is likely to devalue the trademark and erode customer goodwill. Goods that do not conform to the manufacturer's quality standards are not considered "authentic."

From a brand owners' enforcement perspective, there is trademark enforcement and then everything else. Other weapons and approaches exist, as outlined below, but the starting point should always be to analyze trademark rights of the brand owner, as that goes to the heart (or source) of the problem.

II. OTHER LEGAL WEAPONS AND AVENUES OF ATTACK

1. Copyright Infringement

Copyright infringement is the unauthorized copying of a work protected by a copyright registration. The computer age has made it relatively simple for unauthorized dealers to copy images of products taken by the manufacturer or to copy large blocks of text (product descriptions, specification, etc.) written by the manufacturer in order to advertise and offer the manufacturer's products for sale on the internet. Such images and text are often blatantly copied off of a manufacturer's website and simply used by the unauthorized seller on its own website or in product listings on eBay, amazon.com or other sites. Look for unauthorized copying by the dealer of (a) the images provided by the copyright owner of the product; (b) blocks of original text provided by the copyright owner; and (c) logos of the manufacturer used in a manner which falsely implies authorization.

Recently, the Supreme Court made a major pronouncement that mere unauthorized resale of a particular copyrighted item that is imported into the United States is not infringement. In *Kirtsaeng v. John Wiley & Sons, Inc.*, 133 S.Ct. 1357, 201 U.S. Lexis 2371 (2013), the Court held that the first sale doctrine applies to copies of a copyrighted work (like textbooks) which were lawfully made abroad, sold there and then imported into the U.S. for resale as a "new" book. This second sale was held to be beyond the scope of copyright protection. This was a major victory for Costco, eBay and Walmart, which regularly import gray market goods for resale in the U.S. A similar case was heard in 2010 with a 4-4 split decision, on largely the same issues. *Omega, S.A. v. Costco Wholesale Corp.*, 541 F.3d 982 (9th Cir. 2008), aff'd 562 U.S. __, 131 S.Ct. 565 (2010).

However, that does not bar copyright protection against unauthorized dealers in other respects. The unauthorized copying of images and text raises the possibility that the manufacturer can assert a claim for copyright infringement against the unauthorized sellers. No "first sale" of a copyrighted work is involved where the infringer takes directly from the producer in <u>making an offer of sale</u>, without yet completing the sale of the item involved. In other words, while the first sale doctrine may protect the sale of the item, it does not protect infringement of the brand owner's copyrighted images in internet postings to promote the sale of the item.

2. <u>The Interplay of Trademark, Copyright and the Evidence</u>

Recent cases show how these theories tend to play out. Attention is required to develop the specific facts to support the claims. Two decisions in *TechnoMarine* are illustrative. In *TechnoMarine I*, the district court dismissed counts alleging trademark infringement by an unauthorized dealer of non-counterfeit goods, subject to later proof to substantiate such claims. *TechnoMarine SA v. Jacob Time, Inc.*, 905 F.Supp.2d 482 (SD NY 2012). TechnoMarine has designed and made fashionable watches under its TechnoMarine marks. Its sales were contractually permitted only through authorized dealers, most of which are not authorized to sell the products over the Internet, nor to transship to unauthorized retailers for their ultimate resale. Defendant Jacob Time was not an authorized dealer but acquired and resold TechnoMarine watches over its website. TechnoMarine sued on the basis that the sales by Jacob were not "genuine" TechnoMarine watches, even though manufactured by and for TechnoMarine, because the watches lacked the tags and labeling, the standard warranty card and allegedly did not undergo the required post-shipment quality control required of authorized dealers.

However, the district court granted Jacob's motion to dismiss the complaint for failure to allege sufficient facts. On quality control standards, the trademark owner in the Second Circuit must establish in pleading that it has established legitimate, non-pretextual quality control procedures, observes those procedures and that non-conforming sales will diminish the value of its trademark. The mere pleading that authorized watches "undergo a strict quality control procedure" and that these sales did not undergo that process was, without more, insufficient. As for packaging and labels, there was no statement that the difference in packaging or omission of the warranty card "voids the product's warranty," nor other allegation of alteration of the goods.

A second decision in *TechnoMarine* was reported at 2013 U.S. Dist. Lexis 100831 (SD NY 2013) (*TechnoMarine II*). *TechnoMarine II* addressed on defendant's summary judgment motion the accusations of interference with contractual relations and copyright infringement. The district court dismissed the interference count, noting that TechnoMarine had failed to show that defendant was aware of a specific contract with a specific authorized dealer of TechnoMarine, with which defendant allegedly interfered. Merely "knowing in <u>general</u> that a plaintiff has contracts or agreements with third parties" is not enough. (Emphasis added.) The copyright claim was brought for reselling copyrighted works without permission from the copyright holder, running squarely into the first sale doctrine. (See discussion above regarding the *Kirstaeng* case.) While plaintiff argued defendant could not trace its acquisitions from authorized dealers, the court held the first sale doctrine does not place a burden on the defendant to prove a negative, where no evidence "indicates the watches in issue were anything other than genuine TechnoMarine products initially sold via authorized dealers."

Another 2013 case in the Second Circuit dealt with trademark infringement. In *L'Oreal USA, Inc. v. Trend Beauty*, 2013 U.S. Dist. Lexis 115795 (SD NY 2013), defendant was an unauthorized dealer of genuine L'Oreal products. After acknowledging the general rule that sales of new product that are not through authorized dealers does not, in and of itself, constitute trademark infringement, the court then proceeded to analyze the two exceptions under trademark law. Addressing the "quality control" exception, it said that if the unauthorized goods do not conform to the trademark owners non-pretextual quality control standards, it may constitute trademark infringement. Here, the "seal vector" (a coded, printed square on packaging designed to thwart counterfeiting) was such a non-pretextual standard, which had been removed or defaced on defendant's goods. Selling goods without such a seal vector diminishes the trademark's value by making anti-counterfeit efforts less effective. (However, a second quality control measure did not qualify on the record, as the evidence was too skimpy to determine if the measure was merely used as a pretext.)

Material alteration issues may arise from cutting away, grinding off or blurring markings or causing other damage to the packaging or containers. Even a slight difference may suffice to establish infringement, the court noted. The effect of removing the seal vector and coding that would be visible to a consumer was open to factual interpretation, however. Thus, the Court could not grant summary judgment in L'Oreal's favor and required the matter to go to trial.

Some expertise is needed to appreciate the scope of unauthorized dealership law. Not all jurisdictions have the same standards. For one thing, the "quality control" exception is not necessarily recognized in all federal circuits.

3. Customs and ITC Proceedings

If the offender is overseas and exports products into the US, working with the customs service bringing an action before the International Trade Commission (ITC) are options. Customs officials need readily identifiable samples of what is, or is not, authentic. Thus, samples of the valid trademark to compare against a trademark infringer can stop goods at the border, where the difference is readily discernible. However, Customs will generally have a hard time barring "genuine," validly marked goods that originated from the trademark owner. As for the ITC, section 337 of the Tariff Act declares "unlawful" the importation, sale for importation, or sale after importation of any article that infringes a valid patent or registered copyright or registered trademark. For the above restrictions to apply, an industry relating to the protected articles must exist within the United States or be in the process of being established.

For trademark infringement, Section 337 applies not only to importation of counterfeit products but also "legitimate" goods that fall within the "material difference" or "quality control" exceptions discussed above. *See, e.g.*, *In the Matter of Certain Cigarettes and Packaging Thereof* ("Certain Cigarettes"), supra.

Generally, ITC proceedings do not provide damage awards; their function is rather to <u>exclude</u> products from the United States. If the brand owner prevails before the ITC administrative law judge, the ITC will issue an exclusion order barring the infringing articles from entry into the United States. However, aside from the fast track to resolution offered, Section 337 proceedings do provide one distinct advantage over federal court proceedings: the Commission's jurisdiction need not exist over the responding party; it exists over the imported <u>goods</u> themselves, *in rem*.

While an exclusion order will ordinarily be limited to the specific persons found to be in violation, "general exclusion orders" excluding the importation of all infringing articles, regardless of the identity of the importer or infringer are possible. Additionally, the ITC may issue an order to any person violating Section 337to cease and desist.

4. <u>Unfair Competition and False Advertising</u>

Unauthorized online dealers may use false and/or misleading statements in their online advertisements. For example, some online dealers falsely represent that they are "authorized dealers" or that they are "authorized by leading manufacturers." Many dealers also represent that the products they sell are covered by the manufacturers' warranty; while the truth is that many warranties are void when products are sold by unauthorized dealers. These subject the dealer to liability. 15 U.S.C. § 1125(a)(1) states that any person who offers goods or services using any "false or misleading description of fact, or false or misleading representation of fact" if such description or representation (A) is likely to cause confusion or mistake as to the origin, sponsorship or approval of his or her goods or services; or (B) the unauthorized dealer misrepresents the nature, characteristics or qualities of the goods.

States also have statutes that define such misrepresentations as "unfair competition" or as "unfair business practices." *See, e.g.,* California Business & Professions Code § 17200 *et seq.* (creating civil remedies against "unfair competition," which is defined to include any "unfair, deceptive, untrue or misleading advertising").

5. <u>Other State Law Theories</u>

In addition to the above, other theories may be available to assert. For example, under certain facts one may allege the common law tort of interference with prospective business advantage or inducement to breach contract, as noted in the *TechnoMarine II* case described above. Also, state statutes may specifically deal with gray market goods.

A peculiar feature of New York law minimizes the main weapon available to trademark owners. It has a statutory requirement that manufacturers honor warranties even from unauthorized sources. (This alone seems to be a good argument to file unauthorized dealership cases elsewhere, such as California.)

California, in contrast, has additional statutory prohibitions against certain gray market practices. Civil Code Sections 1797.8 et seq. require retail sellers offering unauthorized, imported consumer goods that normally have express, written warranties to post/affix conspicuously certain disclosures. Among them is a warning if the item is not covered by the manufacturer's express warranty or is not eligible for a manufacturer's rebate. Violation of these provisions qualifies for unfair competition under Section 17200 of the Business and Professions Code, entitling competitors to sue.

6. <u>Attacking the Enablers: Amazon.com and the Rest</u>

Going after the infringer is one thing. Another tactic is to go after the enablers. Some companies have begun to seek relief from third parties (primarily service providers) who "enable" the unauthorized dealers under the theory of secondary or contributory trademark or copyright infringement. Targets of secondary liability suits have included (1) internet service providers (ISPs); (2) service providers such as amazon.com who create online market places for the infringing sales; and (3) credit card companies or other payment processors.

In August of 2009, for example, a jury in California held three California-based ISPs liable for contributory trademark and copyright infringement for hosting internet websites used by Chinese sellers to sell merchandise that infringed Louis Vuitton trademarks and copyrights to buyers in the U.S.. The jury awarded Louis Vuitton damages totaling $32.4 million. *Louis Vuitton Malletier, S.A. v. Aknoc Solutions, Inc. et al*., United States District Court for the Northern District of California, Case No. C 07-03952 JW. The jury found the ISPs liable for contributory trademark and copyright infringement because (1) the ISPs "knew or should have known" that the Chinese sellers were using sites hosted by the ISPs to sell infringing products, (2) the ISPs had the power to withdraw their services so that the Chinese sellers could no longer use the websites to sell infringing goods, and (3) the ISPs nevertheless continued to provide services to the Chinese sellers.

A prerequisite to finding service providers liable for contributory infringement is proof that the provider had notice of the infringing conduct by the direct infringer. In the *Louis Vuitton* case, the jury found that the ISPs had received the requisite notice based on evidence showing that, before filing suit, Louis Vuitton sent several notices to the ISPs alerting them to the fact their IP addresses were being used to sell infringing goods. The notices also demanded that the offending websites be removed from the ISPs' servers. Despite the notices, the ISP either allowed the websites to remain operable or simply moved the offending content to a different IP address also hosted by the ISP.

In contrast, in *Tiffany Inc. v. eBay, Inc*., 576 F. Supp. 2d 463 (S.D.N.Y. 2008), Tiffany sued eBay for contributory infringement. The court held that the question of whether eBay could be held liable turned on whether eBay "continued to supply its services to sellers when it knew or had reason to know of infringement by those sellers." *Id*. at 469. The evidence in that case showed that, when Tiffany put eBay on notice of specific auction items that Tiffany believed were infringing, eBay removed the auction listings. *Id*. Tiffany nevertheless argued that eBay should be held liable because eBay had "generalized knowledge" that infringing Tiffany products may be sold on eBay's site and that eBay failed to take preemptive action to monitor its site to ensure that infringing items were not listed or sold. *Id*. The court rejected Tiffany's claim and held that "generalized knowledge" of infringement was not sufficient to impose secondary liability on eBay. *Id*.

In short, brand owners contemplating an action for contributory infringement against service providers such as eBay or an ISP should ensure that they give the service providers notice of specific instances of infringement by the direct infringer. Generalized notice is not sufficient.

But let's go back to amazon.com for a moment. The problem for many brand owners is much more fundamental: there is the issue of "consent." Yes, consent to "unauthorized" sales. If the brand owner listed its product on a detail page with amazon.com (as the main, legitimate seller), amazon.com claims to have notified the owner that the detail page will remain even if the creator's inventory runs out. Amazon then says, *"Additionally, when you add your copyrighted image to a detail page, you grant Amazon and its affiliates a non-exclusive, worldwide, royalty-free, perpetual, irrevocable right to exercise all rights of publicity over the material. Other sellers can list their items for sale against pages that you have created or added your copyrighted images to."*[3]

Will this policy and term hold up if challenged? Interesting question.

7. <u>Attacking Your Own Dealers</u>

Another level of attack is to go against one's own <u>authorized</u> dealers, who may be breaching the terms of their contract with the trademark owner, in selling new product out the back door to unauthorized dealers. This is somewhat cannibalistic, but it can effectively cut off an illicit channel and keep other dealers in line.

III. WHAT ABOUT DMCA TAKE DOWNS OF UNAUTHORIZED DEALER OFFERINGS?

eBay and similar online auction sites have takedown procedures which may be useful against unauthorized dealers. The key word here is "may." Inspired by federal legislation called the Digital Millenium Copyright Act (DMCA), eBay has adopted an even broader means to take down postings offering infringing products beyond those infringing the owner's copyright.

Called the Verified Rights Owner (VeRO) program, eBay permits intellectual property owners to request the removal of listings it claims in good faith are infringing the owner's patent, copyright or trademark rights, through the filing of a simple form called a Notice of Claimed Infringement.[4] Similar to procedures set up in the DMCA, the listing party is notified and has a limited time to file a counter notice to reinstate the listing. If it does so, the owner may have to file suit to enforce its rights in order to keep the listing off, but the listing party will have consented to jurisdiction in the federal court sitting in the Northern District of California. Amazon.com has a similar approach.

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[3] See "Review, Comments, Communications and Other Content" section of Conditions of Use page.
[4] See http://pages.ebay.com/help/tp/vero-rights-owner.html

Outside eBay and websites with similar protections, all auction/sales online sites are subject to the DMCA, which provide similar protections for claims of copyright infringement only.

While simple, the takedown procedures often have a glaring weakness. Sophisticated, unscrupulous unauthorized dealers simply repost the listing using a *different name*. Hence, the DMCA and VeRO programs are sometimes referred to a as a "whack a mole" game, having little real effect. Furthermore, it remains insufficient to advise the website that the sales are "unauthorized." Sometimes persistence is required to get cooperation.