Preventing the Unauthorized Importation of Altered Gray Market Goods: Practical Suggestions for US Trademark Owners

By Peter S. Sloane

When a company searches its trademarks on the Internet through the Google Web site, odds are that it will find advertisements to buy the company's trademarked goods from unauthorized dealers on the gray market placed side-by-side with links to the company's Web site and to the Web sites of its authorized dealers. Those unauthorized dealers are trading off the investment and goodwill in the company's trademarked products and possibly selling infringing goods that are physically and materially different from the genuine goods.

Gray market goods, often referred to as parallel imports, are usually defined as product lawfully produced (*i.e.*, not counterfeit) and purchased abroad but imported without authorization from the US trademark owner. Gray markets exist in merchandise ranging from medical products, such as pharmaceuticals, to luxury products like perfumes and watches to electronic products including cameras and stereo speakers. If left unchecked, gray goods, while not *per se* illegal, can damage the goodwill in the trademark if there are physical and material differences between the genuine product, imported and distributed under the control and supervision of the US trademark owner, and the unauthorized goods usually diverted from authorized distributors of the manufacturer located abroad.

US trademark owners should take advantage of the growing body of case law establishing that such physical and material differences constitute actionable trademark infringement. The growing importance of the Internet in speeding the flow of goods into the US makes it especially important for US trademark owners to consider possible steps to stem the tide of those gray market goods freely piggybacking on their advertising and promotional efforts. The following review of gray goods cases is intended to help US trademark owners spot existing differences between their genuine products and any unauthorized products and to develop new methods to differentiate the authorized from the unauthorized goods.

Peter S. Sloane is a trademark and copyright attorney with Ostrolenk, Faber, Gerb & Soffen, LLP in New York. He may be reached at *psloane@ostrolenk.com*.

Dolls

In one of the earlier gray goods cases, *Original Appalachian Artworks Inc. v. Granada Electronics*,[1] the US Court of Appeals for the Second Circuit found that the unauthorized sale of gray market Cabbage Patch Kids dolls imported from Spain, and not intended for sale in the United States, infringed the rights of the US trademark owner. Unlike the authorized product intended for sale in the United States, the gray goods dolls included "birth certificates" and "adoption papers" written in Spanish. As a result, the fulfillment center of the US trademark owner was either unable or unwilling to process the foreign language documents, resulting in the inability of purchasers to "adopt" the dolls. Consequently, the court found that consumer confusion would result over the source of the product and that the US trademark owner would lose goodwill in its mark.

There are a number of lessons to be learned from the *Cabbage Patch Kids* case. Trademark owners should consider whether there are any differences between the packaging, instructions, warranty cards, or other printed materials distributed with the genuine goods and the materials associated with the unauthorized products. If the printed materials that currently travel with the genuine product are written in multiple languages, the US trademark owner should consider removing the foreign wording to include English only. Over time, this may serve to differentiate the authorized from the unauthorized goods among those knowledgeable consumers who learn that only the authorized goods are packaged with only English language writing.

In the case of warranties, US trademark owners may find it difficult or impossible to process warranties written in a foreign language. As a result, a foreign language warranty for the unauthorized products, if denied coverage by the US trademark owner, may constitute a physical and material difference from the authorized product.

On the other hand, purchasers of the genuine product in the United States may speak languages other than English, making it a practical necessity for the foreign manufacturer and US trademark owner to display multiple languages on printed materials such as warranties.

Furthermore, there may be commercial efficiencies in using the same written materials for products exported to the United States and those sold elsewhere in the world.

Chocolates

In *Societe Des Produits Nestle S.A. v. Casa Helvetia Inc.*,[2] the Court of Appeals for the First Circuit held that chocolates manufactured in Venezuela under the Perugina trademark were materially different from Perugina chocolates manufactured in Italy due to differences in, among other things, quality control methods. As a result, the court found that the unauthorized importation and sale of the Venezuelan-manufactured candies violated the US Trademark Act. According to the court, the fact that a trademark owner is "unable to oversee the quality of the goods for the entire period until they reach the consumer is significant in ascertaining whether a Lanham Act violation exists."

As this decision suggests, having a detailed written policy outlining the proper procedures for the shipment, handling, and storage of imported product may help a US trademark owner in litigation against gray market infringers. That written policy should apply to employees of the US trademark owner, as well as to its authorized retailers. Many gray goods dealers move and unpack product without any special procedures. For example, the gray goods dealer may open packaging to remove the warranty card and/or to alter the serial number for the product. As a result, such goods are often damaged before sale or distribution to the consumer. If the trademark owner can point to an official shipment and handling policy and demonstrate that gray market dealers do not follow the same guidelines, it may convince a court that there are material differences between the authorized and unauthorized goods.

On the other hand, some kinds of non-perishable goods may not be amenable to the same type of quality control safeguards like the chocolates in the *Nestle* case that required storage under certain conditions. Indeed, in *Iberia Foods v. Romeo*,[3] the Court of Appeals for the Third Circuit found the hands-off approach taken by the plaintiff, in merely checking to make sure that the household cleaning products it received were not obviously unmarketable, was insufficient.

Porcelain

Martin's Herend Imports Inc. v. Diamond & Gem Trading U.S.A. Co.[4] is a mixed bag for the US trademark owner. In that case, Martin's, a US corporation, had an exclusive distributorship agreement with the Hungarian manufacturer of Herend brand porcelain. Martin's sued the defendants for selling pieces bearing the Herend trademark purchased from US and foreign sources. The Court of Appeals for the Fifth Circuit found a material difference based merely on the fact that Martin's did not distribute and sell the same pieces imported and sold by defendant Juhasz. However, the Fifth Circuit modified the injunction ordered by the trial court to permit Juhasz to sell all pieces that had ever been sold by plaintiffs in the United States. The court stated that, while plaintiffs should be allowed to maintain the territorial integrity of the trademark by limiting which porcelain pieces are offered for sale in this country, they should not be heard to complain that the trademark is infringed when a product previously offered for sale in the United States is deleted from its current catalog.

What should be taken from this ruling? If possible, the US trademark owner should consider keeping track of those items previously or currently offered for sale in the United States. It may be possible to prevent the unauthorized importation of product made by the foreign manufacturer but never made available for sale here by the US trademark owner.

Cigarettes

In *Philip Morris Incorporated v. Allen Distributors, Inc.*,[5] the trial court found physical and material differences between the authorized and unauthorized cigarettes because the foreign Marlboro cigarettes sold and distributed by the defendants were not subject to Philip Morris' quality control program, which applied only to the authorized distribution of domestic Marlboros. Under that program, Philip Morris' representatives routinely visited wholesalers and retailers to inspect domestic Marlboros. If, through such inspections, product was found to be damaged or otherwise substandard, it was removed and replaced with new product. The court also prohibited the importation of foreign Marlboro cigarettes based, in part, on the absence of Philip Morris' Universal Product Codes. Philip Morris introduced a Marlboro continuity merchandise redemption program that allowed consumers to accumulate "Miles" by saving UPCs located on the side panels of all domestic Marlboros. Once accumulated, those "Miles" were redeemable for various merchandise available from catalogs issued by Philip Morris.

Keeping this decision in mind, it is clear that, if not already in place, a US trademark owner should consider implementing and carrying out a written policy calling for routine inspections of its authorized retailers. A similar policy may be less effective from a trademark protection standpoint for some US trademark owners than for Philip Morris because tobacco, unlike many other goods, can easily become stale and absorb unpleasant odors around it, making proper storage and quality control especially critical. Importantly, the court in *Philip Morris* recognized that Philip Morris could not and did not inspect the smallest retailers of its product for reasons of practicality. Therefore, in order to still be effective, a trademark owner may reasonably apply any such policy to only its largest customers.

Also, US trademark owners should consider having their foreign manufacturers bundle and ship product intended to be sold only in the United States with some other item of value not found in product intended for sale elsewhere. Like the "Miles" available to US consumers in the *Philip Morris* case, this added benefit may help to distinguish the authorized goods intended to be sold in the United States from those unauthorized goods intended for sale abroad.

Fragrances

In *Davidoff & Cie SA v. PLD International Corp.*,[6] the Court of Appeals for the Eleventh Circuit awarded a preliminary injunction against PLD from selling, repackaging, or altering any fragrance product bearing the trademarks Davidoff or Cool Water where the batch code had been removed or obliterated. In awarding the injunction, the court reasoned that the batch codes were vital to Davidoff's quality control efforts because the codes were the only means for Davidoff to recall defective or outdated products. Furthermore, the codes on the bottles had been obliterated by etching the glass, which degraded the appearance of the product.[7]

Trademark owners should consider heavily promoting the existence and importance of product serial numbers affixed to the authorized product or its packaging to potential purchasers in the United States. The US trademark owner also should inform all its US retailers, employees, and other associates to look out for product without the serial number, or with the serial number altered, and to immediately report any such findings directly to the legal department or to the appropriate business people.

The US trademark owner also should consider taking steps to more closely integrate the serial number and trademark as they appear on the product so that the number cannot be removed or altered without damaging the trademark. There may soon be new technologies in manufacturing and security, such as ink visible only under ultraviolet light or holography, that may allow the number to be applied directly underneath or over the trademark. Alternatively, there may be new technologies that make the serial number more resistant than traditional ink to removal or alteration.

Also, companies should consider whether to apply the code to other materials that travel with the goods, such as packaging, product literature, or any warranty card. However, coordinating the serial number on the product with associated printed materials contained within the packaging may be too time consuming or costly from a manufacturing or sales perspective.

The US trademark owner should also consider making changes to its warranty policy in the United States to expressly require that purchasers supply the serial number in order to receive coverage. In any litigation against a gray market infringer, it would help to have an official written policy to rely on as evidence demonstrating the importance of the serial number to any such warranty program. Differences in warranty protection or service commitments between authorized and non-authorized goods may be sufficient to make them non-identical for trademark purposes.[8]

The serial number should also be used to track the source of the gray market goods to the last authorized point of distribution. It is recommended that distribution agreements with authorized dealers contain a provision against transhipment of the trademarked product to third parties. Any authorized dealer of the US or foreign trademark owner should be terminated for unauthorized transhipment. As an added deterrent to transhipment, a liquidated damages provision can be added to distribution agreements.

Other Rulings

In *Lever Brothers Co. v. United States*,[9] the Court of Appeals for the District of Columbia found that § 42 of the US Trademark Act barred importation of foreign goods bearing a trademark identical to a valid US trademark, but physically different, regardless of the trademark's genuine character abroad or affiliation between the producing firms. Accordingly, besides asserting claims against unauthorized importers based on infringement under §§ 32 and 43 of the US Trademark Act, it may also be possible to claim a violation of § 42, which bars the importation of goods bearing infringing names or marks.

Also, in *Pepsi Co. v. Reyes*,[10] a trial court in California found that the defendant's sale of Pepsi soft drinks bottled in Mexico, and imported to the United States without the plaintiff's authorization, constituted, among other things, dilution, since sales of the Mexican products in the United States were likely to create dissatisfaction among retailers and customers, all to the detriment of plaintiff's domestic goodwill, and to injure and tarnish the reputation of plaintiff as symbolized by its famous Pepsi mark. This suggests that a further cause of action for the trademark owner against the unauthorized importation of gray market goods may lie under federal and state dilution grounds.

Conclusion

The cases discussed in this article should provide some relief to the trademark owner confronting a seemingly endless tide of infringing gray market goods. The case law demonstrates a concern by the courts for protecting the rights of the US trademark owner and provides guidance to finding those physical and material differences between the authorized and unauthorized goods necessary to constitute an infringement.

As a practical matter, US trademark owners should identify their authorized dealers to potential purchasers and educate US consumers about the value of buying genuine product only through those authorized dealers. If a warranty program is available only to consumers who purchase their product through authorized dealers, for example, it seems appropriate to inform consumers through advertising or promotional materials. Additionally, the US trademark owner should let consumers know that its authorized dealers have expertise in understanding the history and value of the product. In taking this approach, the US trademark owner should consider instituting an educational program and supplying its dealers with the necessary background materials. Expressly informing potential purchasers in the United States about the differences between authorized and unauthorized product, and the places where those goods are sold, may help to both direct business away from the gray market and to create the kind of evidence that will help convince a court that the differences are material.

Indeed, any steps that a trademark owner can take to differentiate its authorized product from the non-authorized goods, the stronger and more vigorously it will be able to pursue cases against any unauthorized gray market importers and dealers in the courts. US trademark owners should also work closely with their outside attorneys to develop a strategic plan to pursue infringement actions. Well-publicizing the filing of civil actions should go a long way to scaring off infringers who are likely to move on to other easier targets.

Notes

1. Original Appalachian Artworks Inc. v. Granada Electronics, 816 F.2d 68 (2d Cir. 1987).
2. Societe Des Produits Nestle S.A. v. Casa Helvetia Inc., 982 F.2d 633 (1st Cir. 1992).
3. Iberia Foods v. Romeo, 150 F.3d 298 (3rd Cir. 1998).
4. Martin's Herend Imports Inc. v. Diamond & Gem Trading U.S.A. Co., 112 F.3d 1296 (5th Cir. 1997).
5. Philip Morris Incorporated v. Allen Distributors, Inc., 51 U.S.P.Q.2d 1013 (S.D. Ind. 1999).
6. Davidoff & Cie SA v. PLD International Corp., 263 F. 3d 1297 (11th Cir. 2000).
7. *See also* Montblanc-Simplo GMBH v. Staples, Inc., 172 F. Supp. 2d 231 (D. Mass. 2001) (holding that removal of serial numbers from expensive pens resulted in physical scarring that left a material impact on the appearance and integrity of the product); John Paul Mitchell Systems v. Pete-N-Larry's Inc., 862 F. Supp. 1020 (W.D.N.Y. 1994) (holding that removal of batch codes from bottles of hair care products, leaving noticeable scars on the bottles and erasing some of the information printed, constituted a material difference).
8. Societe Des Produits Nestle S.A. v. Casa Helvetia, Inc., 982 F.2d 633 (1st Cir. 1992); Osawa & Co. v. B & H Photo, 589 F. Supp. 1163 (S.D.N.Y. 1984).
9. Lever Brothers Co. v. United States, 877 F.2d 101 (D.C. Cir. 1989).
10. Pepsi Co. v. Reyes, 50 U.S.P.Q.2d 1696 (C.D. Cal. 1999).