

Trademark and Copyright Advisory: Imported Goods: A "Gray" Area in Intellectual Property

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Under certain circumstances, trademark and copyright owners have the right to control the distribution of their products for sale in different markets. Generally, distribution is controlled, at least initially, through a variety of licenses and grants of rights that flow from the original rights holder to both domestic and international manufacturers and distributors. As such, the rights holder relies on contractual restrictions with their manufacturers and distributors to ensure that the product is being sold within legitimate sales channels.

What Are “Gray Market” Goods?

These agreements usually include the trademark and copyright licenses necessary to manufacture and distribute the goods. Often, for a variety of reasons, they also include certain geographic restrictions limiting where the goods can be sold. “Gray market” goods, or “parallel imports,” are genuine items of manufacture (not counterfeit goods), bearing a brand name protected by a trademark or an expression protected by a copyright (*e.g.*, a label or logo), which are distributed outside authorized distribution channels or territories. These goods may be manufactured in the United States and then shipped abroad and subsequently “re-imported” into the United States for resale (*i.e.*, “round trip” goods), or may be manufactured and initially purchased abroad and then imported into the United States by third parties for resale or distribution. Either action may bypass authorized U.S. distribution channels, and may be profitable for the importer either because of discriminatory pricing between U.S. and international versions of the same or very similar products, or because a premium can be charged for international versions that simply are not available in the United States.

When gray market goods enter the United States, the manufacturer is no longer able to control their distribution and pricing. As a result, the manufacturer and authorized U.S. distributors may be forced to “compete” with their own basic product. In many cases, the gray market good is of a different quality than authorized domestic versions, may have different features, or may be sold at a significantly lower price. Not only may a manufacturer suffer monetary loss due to the cannibalization of domestic sales through authorized distributors, but the rights owner’s reputation and goodwill may be adversely affected when uninformed purchasers of the gray market goods discover, for example, that a warranty may be void even though the product is genuine, or that the product quality is less than expected.

A variety of methods have been used by rights holders in an attempt to stem gray market importation, including the use of U.S. trademark and copyright laws. While both can be effective measures under certain circumstances, there are certain defenses available to a gray market

importer that can thwart these efforts. This advisory focuses on one of those defenses—the “first sale” defense as it is applied under both trademark and copyright laws. Under both “first sale” defense doctrines, a rights holder cannot, in certain circumstances, control the sale or distribution of specific goods once they have been legally sold or distributed in the marketplace. After the “first sale” of that specific item, the ability to control further sale or distribution of that item is deemed exhausted. This means that once a registrant sells its product, the buyer ordinarily may resell the product under the original mark (or containing the original copyright) without incurring any trademark or copyright liability.

Is There a Recourse for Trademark Owners?

A trademark owner may attempt to seek protection from the unauthorized sale of gray market goods in the U.S. under 15 U.S.C. §§ 1114 and 1125, which prohibits the unauthorized sale of goods bearing a registered trademark where there is a likelihood of confusion, mistake or deception of purchasers.

The Lanham Act does not impose liability for the sale of “genuine” goods bearing a true mark, even though the sale is not authorized by the mark owner, because such a sale does not result in consumer confusion or dilution. Goods are not considered to be “genuine,” however, if there is a material difference from the product authorized by the trademark holder for sale in a particular geographic location. Thus, a distribution of products that are materially different from the original product bearing the registered trademark creates a likelihood of confusion and constitutes trademark infringement.

In determining whether gray market goods are “genuine” and authorized for sale in the U.S., courts apply the “material difference” test. The threshold of materiality is low, requiring no more than a slight difference that consumers would likely deem relevant when considering a purchase of the product. Courts have found “material” differences in product ingredients, product labels, parts of the label in a foreign language, warranty coverage, lack of compliance with U.S. regulatory requirements, and earlier product versions, to name just a few.

In order to assert a successful gray market trademark infringement claim, the trademark owner must demonstrate that all or substantially all of its own authorized U.S. goods are or have been accompanied by the feature that is materially different from the gray market goods. A sale by a trademark owner of the exact goods which are allegedly “materially different” does not support the assertion that the “gray market” goods create consumer confusion and dilution.

Is There a Recourse for Copyright Owners?

Increasingly, intellectual property owners are turning to the use of copyright laws to curb what they view as the improper importation and sale of gray market goods into the United States. As with trademarks, under U.S. copyright law, the owner of a copyright initially has the exclusive right to authorize or distribute a work protected by that copyright to the public. Further, the “first sale” defense in certain cases terminates the rights holder’s authority to control subsequent sales or distribution of “lawfully made” goods. Thus, the “first sale” defense provides a potential

defense from liability for lawful purchasers of copyrighted materials who then re-sell or distribute those goods in the United States. Copyright law does not use the “material difference” test as the touchstone for determining the applicability of the “first sale” defense. Instead, the current law governing gray market goods focuses on where those goods were manufactured.

With respect to “round trip” goods, the law is fairly settled that a defendant can assert the “first sale” defense to a copyright infringement claim based on infringement of a party’s “distribution” right under 17 U.S.C. § 106(3). The problem arises in the increasingly common instance where goods protected by a copyright are manufactured abroad (under a license from the copyright owner) and are then imported into the United States for resale or distribution by an unauthorized third party. Courts disagree on how the law should be applied in such cases. A pair of recent decisions in the Southern District of New York, *Pearson Education Inc. v. Ganghua Liu, et al.* (Sept. 25, 2009); *J. Wiley & Sons, Inc. v. Supap Kirtsaeng d/b/a BlueChristine99, et al.* (Oct. 19, 2009), demonstrate the difficulty of applying the law in this context. In both *Pearson* and *Wiley*, the court held that because the copyrighted products in question (textbooks) were manufactured *outside* the United States, they were not subject to the protections of the “first sale” defense. Thus, the copyright owners could maintain copyright infringement claims in the United States against the gray market importers under § 106(3).

The basic tensions giving courts pause when considering this issue arise from the inequality of treatment for the same or very similar goods depending on the seemingly arbitrary factor of where they were manufactured, and the sometimes perverse incentives (from a policy perspective) arising therefrom. For example, courts have noted that if the “first sale” defense is not applicable to goods manufactured abroad, then a copyright owner could theoretically pursue infringement claims against all downstream distributors and purchasers, not just the first. Further, the inapplicability of the “first sale” defense to goods manufactured abroad would result in the scenario where U.S. manufactured goods would be entitled to *less* protection under U.S. copyright law than those manufactured abroad (because the domestic goods would be subject to the limitations of the “first sale” defense), thus incentivizing U.S. manufacturing to move overseas to garner broader copyright protection in the U.S. market. Thus, under current law, a rights owner could potentially pursue gray market importers for copyright infringement by incorporating a different copyrighted design or packaging on goods manufactured outside the United States.

Because of this inconsistency in the interpretation of this defense in the copyright context, depending on where the goods were manufactured, there has been increasing pressure for the United States Supreme Court to hear an appeal in which the importation of gray market goods manufactured abroad is squarely at issue. Just such a case has been appealed to the Supreme Court and is awaiting a decision on whether the Court will hear it. In *Omega S.A. v. Costco Wholesale Corporation*, 541 F.3d 982 (9th Cir. 2008), wristwatches manufactured abroad were imported for sale in the United States and a copyright infringement claim was asserted under § 106(3). If review by the Supreme Court is granted, a decision should offer much clearer guidance for copyright owners and importers going forward. Until then, the law remains divided and courts continue to note that this question remains a very close call. While a majority of the courts hold that goods manufactured abroad are not subject to the protections of the “first sale”

defense in a copyright context, a significant minority hold that they are, along with those manufactured in the United States.

For more information on or assistance with this or any other trademark or copyright matter, please contact one of the attorneys listed below or the Mintz Levin attorney who ordinarily handles your legal affairs.

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