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Second Circuit Limits Brand Owners' Ability to Stop Counterfeiting on eBay

On April 1, 2010, a federal appeals court in New York issued a ruling that limits brand owners' ability to stop counterfeiting on the eBay auction website. In a case brought by the well-known luxury jeweler Tiffany & Co. against eBay, the court rejected Tiffany's claim that the law requires eBay to search out and remove the listing and sale of all counterfeit Tiffany goods on eBay. The court held that eBay's generalized knowledge that many Tiffany goods for sale on eBay are counterfeit created no liability for failing to undertake efforts to identify and exclude all listing and sale of counterfeit Tiffany goods. The court also rejected Tiffany's attempt to force eBay to stop its search engine advertising—triggered by the Tiffany trademark—of the availability of Tiffany goods on eBay.

Overview

In *Tiffany (NJ) Inc. v. eBay Inc.*, No. 08-3947 (2d Cir. Apr. 1, 2010), the U.S. Court of Appeals for the Second Circuit affirmed the trial court's judgment in favor of eBay and against Tiffany on several legal claims alleging that eBay violated federal trademark infringement and dilution statutes¹ for failing to stop the sale of counterfeit Tiffany products through its online auctions, and for using the Tiffany mark as a trigger word for eBay's online advertising of the availability of Tiffany items. On the claim that eBay's advertising of the availability of Tiffany goods on the site constituted false advertising,² however, the court held out hope of relief to Tiffany by remanding to the trial court for further findings concerning whether typical consumers would find the advertising's implicit messages misleading.

The court ruled that eBay could not be held liable and required to refuse listing of counterfeit Tiffany items based solely on general knowledge that its site was being used to sell counterfeit Tiffany items. Rather, the court held that the trademark laws require actual knowledge of the counterfeit

nature of particular goods at the time of sale. The decision also rejected an infringement claim directed at eBay's purchase of "sponsor link advertisements"—triggered by a prospective buyer's use of the Tiffany trademark—on Internet search engines Google and Yahoo!

This *Client Alert* will describe more details and discuss the business implications of the *eBay* decision.

Factual Background

eBay is the owner of the popular online auction website on which sellers can offer items for auction or direct sale. The Second Circuit noted, however, that eBay does not ever sell or take possession of the goods sold on its site, but, rather, facilitates direct transactions between sellers and buyers.

To address concerns of both brand owners and buyers that sellers were offering counterfeit goods for sale on the site, eBay implemented several measures designed to remove counterfeit goods from the site and to prohibit listings by sellers known to have repeatedly offered counterfeit goods on the site. Many of these initiatives were specifically tailored toward identifying counterfeit Tiffany goods. In perhaps its most significant general initiative, eBay also implemented a program that permits brand owners to participate in policing the site for listing of infringing and counterfeit items. The program, known as the "Verified Rights Owner ("VeRO") program, provided copyright and trademark owners who identified listings of infringing or counterfeit goods with a formal means to request that eBay remove the listing(s) from the site within 24 hours. eBay also implemented a program allowing brand owners to include "About Me" information concerning their brands on eBay's website.

Tiffany is a well-known purveyor of luxury jewelry available exclusively through Tiffany-approved

retailers, Tiffany catalogs, and Tiffany's website. Due to what Tiffany believed to be the large number of counterfeit Tiffany goods being offered on eBay, Tiffany frequently complained to eBay and sought removal of the listings of these items. Tiffany also participated in the VeRo program and created an "About Me" page that specifically warned readers that many of the supposed Tiffany items offered on eBay were counterfeit. Tiffany's "About Me" page on eBay further advised readers that the only way to be sure that the Tiffany goods it purchased were genuine was to purchase through Tiffany's authorized channels.

By 2004, eBay had taken even further steps to address the large number of counterfeit Tiffany goods being offered on eBay. It sent warnings to all sellers offering Tiffany goods to ensure that the goods they were listing were not counterfeit, and cancelled certain suspicious transactions concerning supposed Tiffany goods. By 2006, eBay even implemented a procedure that delayed the listing of Tiffany goods for sale or auction for 6-12 hours to permit Tiffany more time to examine the listings.

eBay also advertised that its site offered Tiffany goods for sale. In addition to direct Internet ads publicizing the availability of Tiffany goods on eBay, eBay purchased "sponsor link advertisements" on several online search engines. Sponsor link ad purchasers pay to have a listing and a link to their websites when a person using the search engine searches for particular identified words. eBay purchased sponsored link advertising triggered by an Internet user's search for the trademark "Tiffany."

Tiffany's Claims

Tiffany asserted several claims under the Lanham Act to address what it believed

to be the continued offering of substantial numbers of counterfeit Tiffany goods on eBay. Although trademark law generally does not permit a brand owner to restrict downstream sales of its items once an initial authorized sale is made,³ it does permit a brand owner to stop distribution of counterfeit or infringing goods. Specifically, Tiffany claimed that eBay directly infringed and diluted the Tiffany mark by purchasing sponsor link ads on search engines when searchers typed in "Tiffany." As to sellers offering counterfeit goods on eBay, Tiffany claimed that eBay was guilty of inducing or contributing to the counterfeiting activity of the sellers. Tiffany also claimed that eBay's advertising concerning Tiffany goods constituted false advertising because it implied that all of the Tiffany goods listed for sale on eBay's site were genuine.

The Second Circuit's Ruling

The trial court had conducted a one-week bench trial, after which the trial judge issued a detailed ruling rejecting all of Tiffany's claims. On appeal, the Second Circuit affirmed the rejection of all but one of Tiffany's claims.

eBay Not Liable for Direct Trademark Infringement or Dilution Based on Purchasing Sponsored Link Ads Triggered by Internet Searches Using the Word "Tiffany"

The Second Circuit rejected Tiffany's claim of direct trademark infringement and dilution. Specifically, the Second Circuit held that eBay's use of the Tiffany mark both in direct Internet ads and to purchase sponsor link ads on Google and Yahoo! constituted a permissible use of the Tiffany mark under the doctrine of "nominative fair use." This doctrine permits, among other things, a company that trades in a particular branded item to

use the brand name in its advertisements, so long as the advertisement does not create confusion as to whether the trader is affiliated with the brand owner.⁴ The Second Circuit reasoned that eBay's sponsored link advertising truthfully stated that Tiffany goods were offered for sale on eBay and that the ads did not suggest that eBay was affiliated with Tiffany.

eBay Not Liable for Inducement of, or Contributory, Trademark Infringement Based Solely on Generalized Knowledge that Counterfeit Goods Were Regularly Listed

In perhaps the contentious aspect of the decision, the Second Circuit next rejected Tiffany's claim that eBay induced or contributed to the counterfeiting activities of some of the sellers listing purported Tiffany goods by facilitating the sales through its online auction site. The Second Circuit pointed to the Supreme Court's decision in *Inwood Labs., Inc. v. Ives Labs., Inc.*, 456 U.S. 844 (1982), as setting forth the general standard for determining whether inducement of, or contributory, trademark infringement has occurred. Under *Inwood*, a party who is not the direct infringer can be held indirectly liable under the Lanham Act if it "intentionally induces another to infringe a trademark, or if it continues to supply its product to one whom it knows or has reason to know is engaging in trademark infringement."⁵ Other circuits had previously applied the *Inwood* standard to flea market operators, persuading the Second Circuit to apply *Inwood* to eBay's online auction site.⁶

As to *known* counterfeiters, the Second Circuit held that eBay was not liable under *Inwood* because it properly removed these listings promptly upon receiving knowledge of the counterfeiting from Tiffany.

The key contested issue, however, was eBay's liability for the remaining undetected sales of counterfeit Tiffany goods under the *Inwood* "reason to know" standard. In other words, could eBay be held liable for providing online auction services to other, not-specifically-identified sellers of counterfeit Tiffany goods based on eBay's general knowledge (from the number of infringement notices sent by Tiffany to eBay under the eBay VeRO program and through buyer complaints) that counterfeit Tiffany items were regularly being listed?

Tiffany pointed to evidence developed through its "Buying Programs" that about 75 percent of the Tiffany goods sold on eBay are counterfeit—results which it shared with eBay. Tiffany also pointed to the thousands of notices of counterfeit goods it sent to eBay under the eBay's VeRO program and the multitude of buyer complaints eBay received. Tiffany urged that these facts compelled the conclusion that eBay be held liable for the counterfeiting activities of unknown listings of counterfeit Tiffany items.

The Second Circuit, however, rejected the notion that generalized knowledge that many counterfeit items are being sold can trigger contributory liability under *Inwood v. Ives*, particularly in view of the substantial anti-counterfeiting steps that eBay has implemented. In so doing, the Second Circuit admitted that it was adopting a somewhat narrow reading of the *Inwood v. Ives* standard of continued support in the face of a "reason to know" of infringing activity. The Second Circuit, however, believed that the Supreme Court in *Inwood* intended such a narrow reading because the language the Supreme Court used imposed liability on a company only for providing assistance "to one whom it . . . has reason to know is engaging in trademark infringement." (emphasis added).

The Second Circuit thus concluded that the "reason to know" standard was tied to specific instances where a defendant had reason to know of infringement, but did not extend to generalized knowledge that infringement was widespread. The court also noted that such generalized knowledge does not rise to the culpable level of "willful blindness," particularly in light of the substantial anti-counterfeiting measures eBay implemented.

eBay Could Possibly Be Subject to Liability for False Advertising

Finally, the Second Circuit held that the trial court, in dismissing Tiffany's false advertising claim, improperly analyzed the legal issue presented. Tiffany claimed that eBay's advertisements promoting the listings of Tiffany goods on eBay—though not literally false—were impliedly false because they implied that the Tiffany goods listed on eBay were genuine when, in fact, eBay knew that many (possibly a majority) were counterfeit. The Second Circuit remanded the false advertising claim to the trial court for further consideration of whether eBay's Tiffany ads were likely to mislead or confuse consumers. In remanding, the Second Circuit noted that "the law prohibits an advertisement that implies that all of the goods offered on a defendant's website are genuine when in fact, as here, a sizeable proportion of them are not."

Implications of the Tiffany Decision

The *Tiffany* decision has at least four important implications.

First, it represents the first federal appeals court ruling on whether use of another's trademark to trigger sponsored link advertisements is permissible under the Lanham Act where the content of the resulting advertisement is not misleading

and suggests no affiliation between the listing party and the complaining brand owner. Since several district court cases currently pending around the country raise "sponsored link" Lanham Act claims, the Second Circuit's rejection of this claim could hasten the demise of cases based on that theory.

Most of the pending "sponsored link" cases, however, concern suits by brand owners against competitors who used their brand to trigger sponsor link ads for competing products or services. In contrast, the *Tiffany* ruling issued in the context of an online auction site purchasing sponsored link advertising based on the brands listed on the site by third parties. It will fall upon the judges in the other pending district court cases to determine whether the Second Circuit's rationale applies to claims involving a competitor's sponsored link advertising. No matter what the context, however, the critical issue will remain whether the resulting sponsored link advertising is truthful and does not create consumer confusion.

Second, the *Tiffany* decision provides a roadmap for auctioneers, flea market operators, swap meet operators, and other third-party selling sites to avoid being held indirectly liable for the counterfeiting or infringing activity of third-party sellers and directly liable for the false advertising of the goods being offered for sale. The *Tiffany* decision made clear that the more substantial and timely a defendant's efforts to address such unlawful third-party activity, the greater the insulation from indirect liability for others' infringement or counterfeiting.

Third, the *Tiffany* decision to remand Tiffany's false advertising claim could spark a shift in legal tactics in suits brought by brand owners who make claims that auctioneers' and other third-

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party sellers' use in their advertising the brand owner's trademarks. Rather than pitching such claims as trademark infringement claims, the Second Circuit's decision could result in a greater number of such claims being characterized as false advertising claims as the main claim or an alternative claim.

Finally, the *Tiffany* decision makes it clear that claims like Tiffany's—seeking to hold online auction or third-party sales sites liable for the counterfeiting or infringement of participants—face difficult hurdles in the Second Circuit. And because the Second Circuit purported to track the fairly stringent tests articulated by the Seventh and Ninth Circuits several years ago in the context of brick-and-mortar flea markets and swap meets,⁷ it may well be that those two circuits may follow suit. But until the other seven regional circuit courts of appeal rule on this issue (or the U.S. Supreme Court issues a decision on the matter), the issue of contributory infringement for online auctions sites, flea markets and swap sites will remain unsettled throughout most of the United States.

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Endnotes

- 1 See Lanham Trademark Act, 15 U.S.C. §§ 1114 & 1125(c).
- 2 See 15 U.S.C. § 1125(a)(1)(B).
- 3 This is generally known as "first sale doctrine." See, e.g., *Enesco Corp. v. Price/Costco Inc.*, 146 F.3d 1083 (9th Cir. 1998).
- 4 See, e.g., *Volkswagenwerk Aktiengesellschaft v. Church*, 411 F.2d 350, 352 (9th Cir. 1969); *Trail Chevrolet, Inv. v. General Motors Corp.*, 381 F.2d 353, 354 (5th Cir. 1967) (per curiam).
- 5 456 U.S. at 854 (emphasis added).
- 6 See, e.g., *Fonovisa, Inc. v. Cherry Auction, Inc.*, 76 F.3d 259 (9th Cir. 1996); *Hard Rock Licensing Corp. v. Concession Servs., Inc.*, 955 F.2d 1143 (7th Cir. 1992).
- 7 See *Fonovisa*, 76 F.3d at 265; *Hard Rock Cafe*, 955 F.2d at 1149.