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Recommended Citation
http://lsr.nellco.org/nyu_plltpwp/410

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Post-Kirtsaeng, “Material Differences” Between Copyright and Trademark Law’s Treatment of Gray Goods Persist

Charles E. Colman

The U.S. Supreme Court’s recent ruling in Kirtsaeng v. John Wiley & Sons would seem no trivial event for stakeholders in content-reliant industries. The upshot of the Court’s decision—that the Copyright Act cannot be used to prevent the unauthorized importation of copies of works (even if manufactured abroad) whose “first sale” has already occurred—will, at least initially, throw a wrench into many companies’ existing business models.

As one would expect, commentary on the decision has been extensive. With few exceptions, however, commentators attempting to predict the impact of Kirtsaeng have not looked beyond copyright law to understand the broader legal landscape in which so-called “gray goods” are situated. That landscape includes, among other features, the Federal Circuit’s doctrine on rights exhaustion in patent law, the growing number of state laws regulating retailers’ sales of gray goods,

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3 See id.; cf. discussion at John R. Schroeder, Note: Should foreign sales exhaust U.S. patent rights post Quanta?, 55 ST. LOUIS U. L.J. 713, 714 (2011) (“In general, the Federal Circuit has
goods, and the now-widespread use of licenses to restrict the transferability of goods—especially of the digital variety.

As these examples show, the Kirtsaeng ruling does not exist in a vacuum. Indeed, when one examines what is arguably the most significant feature of the gray-goods landscape in the United States—federal trademark law—it is difficult not to wonder if the Supreme Court's ruling will have much of an impact at all. Even a cursory examination of trademark law's gray-goods jurisprudence reveals that it has become untethered from both its supposed consumer-protection and brand-goodwill rationales, opting for an approach that unduly favors trademark owners. Kirtsaeng notwithstanding, trademark law is where the action is.

The framework now widely applied in federal-court trademark litigation over gray goods stems from Societe des Produits Nestle v. Casa Helvetia.5

been relatively liberal in finding that patent holders could prevent the exhaustion of their patent rights by various means. In Quanta Computer, Inc. v. LG Electronics, Inc., [553 U.S. 617, 638 (2008),] the United States Supreme Court began a trend of reeling in the expansion of these methods of preventing patent exhaustion. Following this trend, on March 13, 2009, Northern District of California Judge Claudia Wilken ruled that U.S. patent rights were exhausted by foreign sales or licenses in the case of LG Electronics, Inc. v. Hitachi, Ltd., [655 F. Supp. 2d 1036, 1047 (N.D. Cal. 2009).]  (Footnotes omitted.)


6 See, e.g., Vernor v. Autodesk, 621 F. 3d 1102, 1112 (9th Cir. 2010), cert. den. 132 S. Ct. 105 (Oct. 3, 2011) (“[Autodesk, Inc. customer] CTA was a licensee rather than an ‘owner of a particular copy’ of [Autodesk’s AutoCAD Release 14 software], and it was [thus] not entitled to resell its Release 14 copies to Vernor under the first sale doctrine. 17 U.S.C. § 109(a). Therefore, Vernor did not receive title to the copies from CTA and accordingly could not pass ownership on to others. Both CTA’s and Vernor’s sales infringed Autodesk’s exclusive right to distribute copies of its work. Id. § 106(3).”)

7 982 F.2d 633 (1st Cir. 1992). Courts sometimes cite to an earlier circuit-court case, Original Appalachian Artworks, Inc. v. Granada Electronics, Inc., 816 F.2d 68 (2d Cir. 1987), and occasionally go back even further. But Nestle is most often used as the model in modern cases.
(While the rules applied by U.S. Customs\(^8\) in dealing with gray goods are similar to—and in some instances, were actually the root of—those applied in private litigation under the Lanham Act,\(^9\) space constraints require a focus on the latter.) In \textit{Nestle}, a case over gray-market chocolates, the district court ruled for the importer-defendant. The court acknowledged the existence of case law in which “the Lanham Act [had been] used to uphold infringement by a genuine product,” but observed that in those disputes, “the underlying motive was a material difference which would cause consumer confusion, dissatisfaction, and irreparable harm to the goodwill of the United States’ trademark holder.”\(^{10}\) Here, by contrast, the district court had “closely examined the individual chocolates,” and found that “[a]part from the differences in the boxes, wrappers and trays, the appearance of the individual chocolates, wrapped and unwrapped were almost undistinguishable.”\(^{11}\)

The First Circuit reversed. The appellate panel began its decision by framing the inquiry from the perspective of brand owners wishing to engage in market segmentation (rather than, say, consumers wishing to obtain comparable goods at the lowest available price), stating that “[this] appeal requires us to address the protection that trademark law affords a registrant against the importation and sale of so-called ‘gray goods,’ that is, trademarked goods manufactured abroad under a valid license but brought into this country in

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\(^8\) See 19 C.F.R. § 133.23 (“Restrictions on importation of gray market articles”).
\(^9\) 15 U.S.C. § 1051 \textit{et seq.}
\(^{11}\) Id. at 164.
derogation of arrangements lawfully made by the trademark holder to ensure territorial exclusivity.”

Declaring its intention to rule based on the Lanham Act’s “amaranthine principles” of “protecting consumers” and “protecting registrants and their assignees”—which the court deemed to be “linked to a concept of territorial exclusivity”—Judge Bruce Selya wrote, for a unanimous panel:

[A]lthough it has been said that “trademark law generally does not reach the sale of genuine goods bearing a true mark even though such sale is without the mark owner’s consent,” . . . the maxim does not apply when genuine, but unauthorized, imports differ materially from authentic goods authorized for sale in the domestic market. . . . In other words, the unauthorized importation and sale of materially different merchandise violates [the Lanham Act] because a difference in products bearing the same name confuses consumers and impinges on the local trademark holder’s goodwill.

In the panel’s view, there was “no mechanical way to determine the point at which a difference becomes ‘material,’” but it could “confidently say that the threshold of materiality is always quite low in such cases.” Based on this lax standard, the court found it “readily apparent that material differences exist between the Italian and Venezuelan PERUGINA” chocolates at issue in the litigation. The panel acknowledged that “[t]hese differences – which implicate quality, composition, packaging, and price – are not overwhelming,” but found that “[g]iven the low threshold of materiality that applies in gray goods cases”—a

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12 Societe des Produits Nestle v. Casa Helvetia, 982 F.2d 633, 635 (1st Cir. 1992).
13 Id. at 638.
14 Id. at 641.
15 Id. at 643.
standard that the panel itself had just formalized—“the above dissimilarities are material in the aggregate.” Trademark liability for the defendant followed.

Courts presiding over Lanham Act gray-goods disputes in the wake of Nestle have largely adopted the First Circuit’s framework. In Martin’s Herend Imports v. Diamond & Gem Trading USA, for example, the Fifth Circuit wrote that it was “persuaded that the [Nestle] test, which finds infringement if the goods sold by the authorized domestic distributor and the defendant’s foreign goods are materially different, is a sound one, at least when the goods in question are highly artistic, luxury goods.” In an illuminating passage, the panel wrote:

Once a trademark owner sells his product, the buyer ordinarily may resell the product under the original mark without incurring any trademark law liability. An analogous and better known first sale rule is recognized in the copyright law, and is indeed codified in the Copyright Act. This rule “finds its origins in the common law aversion to limiting the alienation of personal property.” As one court has explained, the rationale behind the rule is that after the first sale, “the policy favoring a copyright monopoly for authors gives way to policies disfavoring restraints of trade and limitations on the alienation of personal property....” Similar policies underlie recognition of a first sale rule in trademark law. We conclude that this rule does not protect [the defendant]. First, the rule applies only to identical genuine goods [and] “[a]n unauthorized importation may well turn an otherwise ‘genuine’ product into a ‘counterfeit’ one.”

Other circuits followed suit, most declining to adopt the Fifth Circuit’s caveat regarding “highly artistic, luxury goods.” Thus, in Davidoff & Cie, S.A. v. PLD Int’l Corp., the Eleventh Circuit began its opinion by “recogniz[ing] the general rule that a trademark owner’s authorized initial sale of its product exhausts the

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16 But see id. at 644 (“The use of the same PERUGINA label on chocolates manifesting such differences is presumptively likely to cause confusion. Casa Helvetia could, of course, have offered evidence to rebut this presumption -- but it has not done so. There is no proof that retailers explain to consumers the differences between the Italian and Venezuelan products. The record is likewise devoid of any evidence that consumers are indifferent about quality control procedures, packaging, ingredients, or price.”)
17 112 F.3d 1296, 1301-02 (5th Cir. 1997).
18 Id. at 1303 (internal citations omitted).
trademark owner’s right to maintain control over who thereafter resells the product,” but “adopt[ed] from our sister circuits their exception to this general rule—i.e., the unauthorized resale of a materially different product constitutes infringement.”19 The court placed no limitations on the goods eligible for this test.

As one federal court after another has adopted the *Nestle* framework, and in the process, added to the list of potentially “material” differences between goods for purposes of trademark liability, dealing in most types of gray goods has become a risky endeavor. The boundaries of permissible conduct are difficult to locate in the case law; in *Iberia Foods Corp. v. Romeo*, the Third Circuit went so far as to state that “[b]ecause consumer preferences are as fickle and diverse as the human imagination, it is impossible to devise an exhaustive list of the types of differences between products that can be considered material for the purposes of the genuineness test.”20 After two decades of such decisions, the only thing one can say for certain is that the purported “general rule”—“that a trademark owner’s authorized initial sale of its product exhausts the trademark owner’s right to maintain control”21—has now become the exception.

In the relatively recent case of *Zino Davidoff SA v. CVS Corp.*, defendant-appellant CVS tried to remind the Second Circuit of the proper baseline for the analysis, pointing out that “neither the plain text nor the legislative history of the Lanham Act supports the district court’s conclusion that a retailer may be found liable for trademark infringement for selling a genuine product in its original

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19 263 F.3d 1297, 1298-99 (11th Cir. 2001).
20 150 F.3d 298, 304 (3d Cir. 1998).
21 *Davidoff & Cie*, 263 F.3d at 1298.
packaging with the registered trademark intact, simply because the mark holder’s production code has been altered or removed." The court brushed this observation aside, citing previous decisions for the proposition that “goods are not genuine if they do not conform to the trademark holder’s quality control standards . . . or if they differ materially from the product authorized . . . by the trademark holder for sale.”

The Zino Davidoff court further asserted that where “the alleged infringer has interfered with the trademark holder’s ability to control quality”—as it found had occurred through the removal of the goods’ UPC code (a product element that, one imagines, very few consumers would consider “material”)—the importation of ostensibly “genuine” goods may be infringing. But the sweeping range of product characteristics now deemed sufficiently material to prevent the importation of gray goods under the Lanham Act suggests that the truly relevant part of quality control, for certain brand owners and (knowingly or not) for many courts, is mere control.

Consider, for example, the Fifth Circuit’s passage in Martin’s Herend Imports on which a finding of “material differences” was based: “Some of the pieces, such as figurines of guinea hens and rabbits, were completely different

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22 571 F.3d 238, 243 (2d Cir. 2009)
23 Id.
24 See generally 2-5 GILSON ON TRADEMARKS § 5.20[3] (2012). In footnote 91, Gilson cites one of the very few post-Nestle court decisions rejecting the alleged materiality of differences between the products at issue: American Home Prods. v. Reliance Trading Co., 55 U.S.P.Q.2d 1756 (C.D. Cal. 2000) (“[T]he fact that the goods have traveled overseas in no way renders them materially different. At most, the goods have lost part of their shelf-life.”) That this is the decision used by a leading treatise to illustrate differences that are not “material” underscores how imbalanced trademark law’s gray-goods jurisprudence has become.
pieces from those sold by Martin’s. Others had painted patterns and colors different from those offered by Martin’s. As a matter of law, such differences are material [and the importation of the goods thus infringing], since consumer choices for such artistic pieces are necessarily subjective or even fanciful, depending on each consumer’s personal artistic tastes.

Product quality is not mentioned at all: in some instances, apparently, mere aesthetic differences are per se “material.”

For a company to cater to local tastes is one thing; for a court to rule in favor of a trademark owner in the absence of any evidence that such legitimate business motives underlay its distribution decisions—and in the absence of any evidence of likelihood of confusion, which is “presumed” where product differences are material—is quite another. (Further, where the relevant concern is quality control, should U.S. trademark law really go out of its way to enable the controlled sale of lower-quality goods abroad, provided U.S. customers are not exposed to them?)

In short, courts have faithfully—even blindly—heeded Judge Selya’s counterintuitive instruction in Nestle that “a reviewing court [examining gray goods for ‘material differences’] must necessarily be concerned with subtle differences, for it is by subtle differences that consumers are most easily confused.” Judges have thus found prominent differences “material,” and

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25 Martin’s Herend Imports, 112 F.3d at 1302.
26 Id. at 1301 (“Nestle did not turn on proof by the plaintiff of consumer confusion. Instead, it presumed a likelihood of confusion as a matter of law when the products are materially different.”)
27 Id. at 641.
subtle differences likewise “material,” such that what was intended as a test grounded in sensible policy is now a rule lacking any coherent underlying principles—and one that effectively bars the unauthorized importation of most goods bearing the trademarks of U.S. companies. Importantly, this rule, especially when applied with the benefit of advance planning that will take place in post-*Kirtsaeng* strategy sessions, can be applied to not only copyrightable works like the textbooks at issue in *Kirtsaeng*, but to nearly any type of good.

Thus, it seems that (as has so often occurred in IP law) the focus on the problems of copyright and patent has allowed trademark law to engage, unsupervised, in a great deal of mischief.\(^{28}\) If it is “copyright misuse” to strategically deploy copyrightable material in an effort to carry out market segmentation,\(^{29}\) surely there is a colorable argument that it constitutes *trademark misuse*\(^{30}\) to use the Lanham Act to keep out parallel imports for the purpose of price discrimination through token product differences that—under the courts’ increasingly incoherent, post-*Nestle* jurisprudence—will more often than not be ruled material (no matter how trivial they may seem to consumers.)

A shift in focus is warranted: commentators and stakeholders must take a step back and look at the bigger picture surrounding gray goods. Regardless of


whether the copyright-law issues addressed in *Kirtsaeng* receive further attention in Congress, control over the importation of gray goods is by no means a thing of the past—because trademark law will effectively preserve the anti-gray goods *status quo*. If this scenario is consistent with the policy choices of U.S. voters and their representatives, perhaps the “material differences” test should be left as is—or even abandoned in favor of an across-the-board prohibition. That state of affairs would, at least, have the benefit of transparency.

However, the myopic focus of most post-*Kirtsaeng* commentary suggests that the relevant decisionmakers are not yet in a position to provide “informed consent” to the law as it stands now. With a more comprehensive understanding of current trademark-law jurisprudence, they may find themselves confused, and frustrated—and hopefully, motivated to advocate for legal reform.

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31 *See supra* at note 2 (“The decision, however, is not likely to be the final word. In statements following the ruling, both sides referenced a congressional battle that all stakeholders have anticipated from the start of the litigation.”)