

Ways Manufacturers Can Shut Down Unauthorized Resellers

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The internet has become a dominant marketplace for consumer products and services. Historically, high capital costs of warehouse and storefront facilities tended to discourage unauthorized resellers from becoming a significant factor in the market. Now, with little upfront capital, online resellers have direct access to consumers through online marketplaces established by companies such as Amazon.com Inc., eBay Inc., Newegg Inc. and Alibaba Group Holding Ltd. and/or through the resellers' own websites. While the resulting explosion of internet sales has generally benefited most brand owners, it has created an increased potential for intellectual property violations by unauthorized resellers seeking to profit from product sales without paying for intellectual property associated with those products.



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Online retailers that sell counterfeit goods are the simplest to address from a legal perspective. If the original product manufacturer (also referred to as “brand owner”) has patented aspects of the product, the brand owner can bring patent claims against the unauthorized reseller. To the extent the brand owner has trademarks protecting logos, product names or slogans associated with the product, these trademarks can be enforced through the courts. Finally, if the brand owner has copyrighted material that is being copied and used by the counterfeit retailer (e.g., product literature, advertising or software), the brand owner can also enforce these copyrights.

The more complicated legal situation arises, though, when an online reseller obtains and then sells genuine products that were actually manufactured by the brand owner. Unauthorized resellers may obtain these genuine articles through a variety of means: they may buy the products as returns and/or through clearance sales from authorized resellers or dealers; they may buy the products overseas at lower prices and then import into the United States (“gray market” sales); they may acquire stolen goods that have been diverted from the brand owner’s distribution chain; or, they may buy the products at a bulk discount from an authorized reseller that is looking to dump its inventory for some reason, such as changing product lines or ceasing to do business.

Whatever the source, by operating outside the brand owner’s authorized distribution channels, these unauthorized resellers may be able to undercut the pricing of authorized dealers and resellers: They pay little if anything for overhead, advertising, showrooms, quality control, customer service and/or warranty activities. They are essentially free riders, profiting from the brand owner’s and authorized resellers’ established reputation for quality, advertising and customer service without contributing to these activities.

While the brand owner’s legal rights with respect to unauthorized resellers of genuine products may not be as clear-cut as with counterfeit sales, brand owners do nevertheless have rights that they should consider enforcing in these situations.

Patent Infringement and Exhaustion

Where the unauthorized reseller secures a product through a lawful purchase, patent infringement claims may be difficult, even if the brand owner has patents covering features of the product. This is because of the doctrine of “exhaustion,” which generally provides that a patent owner “exhausts” its patent rights when it sells a patented product to another.[1] Therefore, if the unauthorized reseller purchases the product in a lawful sale (as opposed to, for instance, a knowing purchase of stolen goods), then patent claims may not have much utility in terms of shutting the unauthorized reseller down.

Trademark Infringement and the First Sale Doctrine

Trademark infringement claims can be brought against a party that uses a trademarked name, logo or slogan in connection with a sale that has not been authorized by the original product manufacturer. Lanham Act, 15 U.S.C. § 1114. As with exhaustion of patent rights, though, the trademark owner generally loses its right to enforce the trademark after the “first sale” by the manufacturer; the “first sale doctrine” holds that someone who purchases a branded product generally has the right to resell that product so long as the product is in the same condition as when it was purchased.[2]

There is an exception to the “first sale doctrine,” though, known as the “material difference exception”: If some aspect of the unauthorized product purchased by the consumer differs materially from a product purchased from an authorized reseller, the trademark right is not exhausted.[3] This “material difference” can be a physical difference, such as when the product has been refurbished with non-original parts, or where packaging has been altered through removal of bar codes and other tracking information.[4] Or the difference can be in some form of associated service or warranty that would come with an authorized purchase of the product.[5] Original product manufacturers have had the most success in proving the “material difference” exception where (1) the product is not covered by a warranty unless purchased by an authorized reseller, (2) customer service is not available for the product, or (3) labeling and/or packaging (such as warning labels) have been altered or removed in the re-sold product.[6]

In addition to the “material difference exception,” some jurisdictions, such as New York and California, have found a “quality control exception” where a brand owner can establish that the quality control standards of the unauthorized reseller are substantially lower than the original manufacturer and/or authorized resellers, and therefore the brand owner’s reputation for quality is being undermined by the unauthorized resales.[7] For instance, the sale of expired cosmetic products in violation of the brand owner’s quality control standards was found to constitute trademark infringement despite the first sale doctrine.[8]

Copyright Infringement

The internet has made it easy for an unauthorized reseller to copy product images as well as product descriptions, specifications, data sheets, etc. from a brand owner's website, in order to advertise and sell branded products over the internet. This copying may give rise to a claim for copyright infringement, i.e., the unauthorized copying of images or written work protected by a copyright registration.[9]

Like with trademark claims, though, the "first sale doctrine" may be a defense to claims of copyright infringement that seek to recover on the basis of resales of copyrighted materials, e.g., books or photographs.[10] However, where the unauthorized reseller uses copyrighted materials (e.g., images, verbatim product descriptions and data sheets) that do not constitute the product, but are used in promoting the product, a claim may lie — the claim is not a claim based on the sale of a copyrighted work, but rather the use of copyrighted materials in offering the product for sale. Damages for copyright infringement may include actual damages and any wrongful profits earned by the infringer, and statutory penalties. In addition, the infringer may be enjoined from any further use of the copyrighted material.

Unfair Competition

If the unauthorized reseller utilizes false and/or misleading statements in its online advertising, the brand owner may have a legal claim for unfair competition.[11] Section 1125(a)(1) of the Lanham Act prohibits sales practices that are likely to cause a consumer to be misled as to the origin of goods and/or the nature or characteristics of a product. Likewise, states such as California and New York have laws that preclude any unfair, untrue or misleading advertisement.[12] And states such as California have specific "gray market" laws that require product resellers offering unauthorized, imported consumer goods that are not covered by warranties to clearly mark on the package that the products are not covered.[13] Accordingly, if the unauthorized retailer falsely states or suggests that it is an authorized retailer, and/or that its products are covered by the manufacturer's warranty when they are not, the unauthorized reseller may be liable under an unfair competition or false advertising theory.

Legal Action to Shut Down Unauthorized Resellers

A brand owner that learns of unauthorized resale activities has several options. First, to the extent the unauthorized resales occur through online marketplaces such as eBay or Amazon, these websites have voluntary takedown procedures that may in some cases enable the brand owner to achieve the removal of the offending resale activity from those sites without legal action. While this will not provide the brand owner with damages or relief beyond the specific website takedown, in many cases this approach will provide sufficient relief without incurring the expense of litigation.

If voluntary takedown procedures fail to provide a sufficient remedy, the brand owner may seek to enforce its rights in a state or federal court, or in the U.S. International Trade Commission. If proceeding in a court, the brand owner may recover damages as well as injunctive relief — enjoining the infringing party from further infringing activity. If proceeding before the ITC, the brand owner will not recover damages, but may obtain an exclusion order that will bar the offending products from entering the United States (exclusion orders are enforced by Customs).[14]

In order to take maximum advantage of these legal theories, a brand owner should carefully craft quality control and warranty policies. Some courts have held that, in order to qualify for the “quality control” exception to the first sale doctrine, the brand owner needs to prove that it maintains a bona fide quality control program.[15] In order to assure that the brand owner will qualify for the “warranty” exception, the brand owner should establish written warranty policies that make clear that purchase of products from unauthorized resellers will void any product warranties. Brand owners should also check the warranty laws of any state in which they sell goods, since some states maintain laws requiring warranty protection even for goods sold by unauthorized resellers.[16] If these steps are followed, brand owners should be able to protect their companies and products from meaningful harm caused by unauthorized resale activity.

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[1] The Federal Circuit recently held that a brand owner may in some circumstances place post-sale restrictions on the resale of its products, so that its patent rights are not exhausted, and that overseas sales by a patent owner may not exhaust the patentee’s rights in United States. *Lexmark Int’l v. Impression Prods.*, 816 F.3d 721 (Fed. Cir. 2016). The Supreme Court is scheduled to consider a petition for certiorari with respect to the *Lexmark* decision next term.

[2] *Sebastian Int’l, Inc. v. Longs Drug Stores Corp.*, 53 F.3d 1073, 1074 (9th Cir. 1995) (“the right of a producer to control distribution of its trademarked product does not extend beyond the first sale of the product”).

[3] See *Hokto Kinoko Co. v. Concord Farms, Inc.*, 738 F.3d 1085, 1093 (9th Cir. 2013).

[4] See e.g., *Davidoff & Cie, S.A. v. PLD Int’l Corp.*, 263 F.3d 1297, 1303 (11th Cir. 2001) (physical difference created by the removal of the batch code on defendant’s product constitutes a material difference).

[5] See *Heraeus Kulzer LLC v. Omni Dental Supply*, No. 12-11099-RGS, 2013 U.S. Dist. LEXIS 91949, at *17-18 (D. Mass. July 1, 2013) (finding material difference due to variations in customer support and warranty coverage between foreign and domestic products).

[6] See e.g., *Bose Corp. v. Ejaz*, 2012 U.S. Dist. LEXIS 130953, 2012 WL 4052861, at *9 (D. Mass. Sept. 13, 2012) (one year difference in warranty between domestic and foreign radio systems constituted material difference); *Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.*, 982 F.2d 633, 643 (1st Cir. 1992) (cosmetic differences as to the color and finishes in the products' packaging were material).

[7] *Warner-Lambert Co. v. Northside Dev. Corp.*, 86 F.3d 3, 6 (2d Cir. 1996) ("distribution of a product that does not meet the trademark holder's quality control standards may result in the devaluation of the mark by tarnishing its image").

[8] *Mary Kay, Inc. v. Weber*, 661 F. Supp. 2d 632, 642 (N.D. Tex. 2009) (granting injunction where mark holder takes legitimate steps to ensure its products' freshness and that it sells a minimal amount of expired products).

[9] 17 U.S.C. § 106.

[10] 17 U.S.C. § 109(a).

[11] Lanham Act, 15 U.S.C. § 1051 et seq.

[12] Cal. Bus. & Prof. Code § 17200 et seq.; N.Y. Gen. Bus. Law § 349 et seq.

[13] Cal. Civ. Code § 1797.81(1) et seq.

[14] See Tariff Act of 1930, 19 U.S.C. § 1337; *SKF USA Inc. v. ITC*, 423 F.3d 1307 (Fed. Cir. 2005); *Gamut Trading Co. v. ITC*, 200 F.3d 775 (Fed. Cir. 1999).

[15] See *Mary Kay, Inc.* at 642.

[16] See, e.g., N.Y. Gen. Bus. Law § 369-b.