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How to stop grey goods

The liberalization of international trade means big challenges for IP rights owners. Louis S Ederer and Andrew Bernstein of Torys LLP analyze how brand owners can combat grey goods in Canada using trade mark and other laws

The liberalization of international trade in the past decade has been of tremendous benefit to North American businesses. However, it has also posed certain challenges, particularly for trade mark owners whose products are sold in many countries. A trade mark owner has the right, among other things, to authorize the making and selling of its products in particular countries, through particular trade channels. But trade mark owners have been unable to control the diversion of goods, originally intended to be sold only in certain countries, to other countries where they were not intended to be sold. When imported into countries such as Canada and the United States, where they were not intended to be sold, these diverted products are known as grey market goods.

Trade mark law, which ordinarily permits only a trade mark holder (or his designee) to sell goods bearing its marks within a particular territory or country, will not typically prevent the sale of diverted grey market imported goods that were originally authorized to be made or sold only in another territory or country. The doctrine of exhaustion or the right of first sale generally means that once legitimate goods bearing a mark are sold anywhere in the world, the purchaser has the right to import or resell them. This permits an unauthorized entrepreneur to purchase trade marked goods in a low-price jurisdiction, and import and resell them into a high-price jurisdiction.

This, of course, can have serious adverse consequences for businesses. By depleting the products in the low-price jurisdiction, grey marketing elevates local prices, making the product less attractive to local buyers. More important, grey market products imported into a high-price jurisdiction compete at a low price with the manufacturer's own products and diminish the manufacturer's control over its own brands. Hence, businesses with widespread international sales have a strong interest in resisting and controlling grey marketing.

This article analyzes the avenues available to businesses seeking to challenge grey marketing in Canada, using trade mark law as well as some other available legal regimes.

Resisting grey marketing on the basis of trade marks

Under Canadian law, the sale of grey market goods does not typically constitute trade mark infringement. In a nutshell, that is because of the underlying purpose of trade mark law, which is intended to protect consumers from confusion about the source of goods (that is, ensuring that the cola inside the can marked Coca-Cola is actually made by The Coca-Cola Company or its licensee). Because, by definition, grey market goods originate with or are ultimately authorized by the mark holder or a licensee (over whom the mark holder must assert

An action for trade mark infringement may assist in preventing the importation and resale of grey market goods

quality control), there cannot be any confusion about the source of the goods, and therefore no infringement.

The fact that prohibiting grey market goods does not further the purpose of trade mark law, combined with the doctrine of exhaustion and the common-law courts' natural reluctance to extend a mark holder's monopoly further than necessary, means that courts have been unwilling to regulate their sale. Nevertheless, it is still possible to enforce trade marks against grey market products under certain circumstances, and this can be done through an action for infringement, an action for passing off, or an action for depreciation of goodwill.

Trade mark infringement

Where a Canadian company is the registered owner of a Canadian trade mark, the courts have been willing to stop the importation and sale of the grey goods bearing that trade mark under certain circumstances. Section 19 of the Trade-marks Act of 1985 (the Act) grants the owner of a registered Canadian trade mark the *exclusive* right to use the trade mark throughout Canada. That right would, arguably, be infringed by the sale of grey products that did not originate in Canada.

For this argument to be successful, the international manufacturer/seller of the goods must be *distinct* from the trade mark owner in Canada. This permits the Canadian trade mark owner to argue that it did not exercise its right of first sale over the goods, and therefore its trade mark rights are not exhausted. Helpfully, Canadian courts have also extended this protection to Canadian subsidiaries of multinational corporations. Generally, if a multinational corporation produces and sells a product abroad, and that product is imported by a grey marketer into Canada, the corporation cannot complain of trade mark infringement. This would be true even if the Canadian subsidiary of the corporation owned the Canadian trade mark, since the corporation would have exhausted its rights by the sale of the product abroad. However, according to Canadian courts, if a Canadian subsidiary of a multinational can *sufficiently distance itself* from its parent, the subsidiary can assert its rights in a Canadian trade mark against the grey marketer. Although at least one case (*Remington Rand Limited v Transworld Metal Company Limited*, [1960] Ex CR 463) has held that all that is required is a separate corporate existence (which is as simple as setting up a subsidiary), the current law also requires a *differentiated product*. This makes sense in the context of trade mark law, since if a foreign product has characteristics that are different from the domestically marketed product, such as a different composition, different warranty, different after-market service, or it conforms to different standards, it would be more likely to confuse consumers, who believe they are buying the Canadian version of the product that they are accustomed to (*H J Heinz Co of Canada Ltd v Edan Food Sales Inc* (1991), 35 CPR (3d) 213).

Of course, for an infringement case to be brought, the domestic producer must have sufficient rights in the trade mark. That is, the mark must be sufficiently distinctive to the Canadian owner of the trade mark, as opposed to the international manufacturer. For example, the courts invalidated the Canadian registration of an international trade mark that had long been owned in Canada by the multinational trade mark owner before Canadian registration by a Canadian distributor (*Wilkinson Sword (Canada) Limited v Juda*, [1968] 2 Ex CR 137; *Breck's Sporting Goods v Magder* (1976), 1 SCR 527; *Havana House Cigar & Tobacco Merchants Ltd v Skyway Cigar Store* (1998), 81 CPR (3d) 203). Indeed, raising this issue in an interlocutory injunction application with respect to grey market goods has been sufficient to avoid the injunction (*Ulay (Canada) Ltd v Calstock Traders Ltd* (1969), 59 CPR 223 (Ex Ct)). On the other hand, H J Heinz Co of Canada Ltd, owner of the Heinz trade mark in

Canada, successfully used its Canadian trade mark to stop the unauthorized importation of Heinz ketchup that was manufactured and marked by its US parent (see above).

In sum, it appears that under the right circumstances (a separate corporate entity, a differentiated product and a mark that is actually distinctive to that entity and product), an action for trade mark infringement may assist in preventing the importation and resale of grey market goods.

Passing off

If there is no Canadian registered trade mark, an attempt can be made to prevent importation of grey market goods through an action for passing off (*Consumers Distributing Co v Seiko Time Canada Ltd* (1984), 1 CPR (3d) 1 (SCC)). This involves making a claim that the grey goods are being misrepresented as products authorized for distribution in Canada by the manufacturer. Nevertheless, like an action for infringement, such an action will only be possible when the entity and the products are sufficiently differentiated. Indeed, according to the Supreme Court of Canada in the above case, passing off requires "a misrepresentation or deceit of some kind to the public by reason of the sale of grey goods". In other words, a Canadian distributor cannot prevent the importation and sale of grey products as long as the products are identical and come from the same source. However, where the grey goods differ sufficiently from the original products, preventing their sale may be possible. Of course, the standard for what constitutes a "misrepresentation or deceit" is relatively high. Indeed, products that did not include warranties were found to be acceptable for sale as long as customers were given notice that no after-sale support would be available to them. On the other hand, an interlocutory injunction was successfully obtained against products that had not received Canadian Standards Association certification, even though the grey products were identical to the Canadian versions and the grey products had received certification in the United States (*Sharp Electronics of Canada Ltd v Continental Electronic Info Inc* (1988), 23 CPR (3d) 330 (BCSC)).

Like an action for trade mark infringement, an action for passing off against a grey market reseller requires a distinct Canadian entity. Indeed, despite an earlier ruling to the contrary (*Matell Canada Inc v GTS Acquisitions & Nintendo of America Inc* (1989), 27 CPR (3d) 358 (FCTD)), the Federal Court of Appeal also held that licensees and registered users of international trade marks cannot take advantage of most of these legal remedies (*Smith & Nephew Inc v Glen Oak Inc* (1996), 198 NR 302 (FCA)). It is therefore not surprising that, as the Court commented in this case, "the action in passing off, whether statutory or common law, has not met with marked success as a weapon against grey marketing".

Copyright ownership may also provide another venue for challenging the importation of grey goods

Action for depreciation of goodwill

Section 22 of the Act prohibits a person from using a trade mark registered by another person in a manner that is likely to depreciate the value of the goodwill attaching to the trade mark. Of course, such a depreciation can occur only when the foreign marked product is different from the domestic one. However, this difference alone is insufficient to establish a case. The plaintiff must also establish that grey market goods will, in fact, result in a loss of goodwill. Courts have taken a relatively strict view of this element and rejected mere speculative evidence of this loss (*Havana House Cigar*, above, at para 80). For example, in this case it was argued that unauthorized importation of lower quality cigars would depreciate the goodwill associated with the cigar's trade mark since consumers receiving the lower quality cigars would stop buying them. The Federal Court held that this was mere speculation and that actual market evidence would have to be presented before the Court could find depreciation. Given the difficulties associated with developing this evidence in a timely way, and that the usual context to prevent the importation of grey market goods is a motion for an injunction, it is safe to predict that this section will be of limited use in preventing the importation or sale of grey market goods.

Other legal regimes for resisting grey goods

There may be other ways to stop the sale of grey market goods. Recourse may be available under several regulations. For example, natural health products, cosmetics, and drugs are regulated by the federal government. Health Canada, no doubt, would have significant issues with any imported products that are improperly registered or packaged. Failure to comply with federal and provincial packaging and labelling requirements could also result in preventing the importation of grey products. For example, virtually all consumer products require bilingual and metric labelling. Any products that lack these elements in their packaging cannot be legally marketed in Canada. Finally, if the manufacturer or distributor of a product owns Canadian patent or industrial design rights to that product, unauthorized importation of the product would constitute an infringement of those rights.

Copyright ownership may also provide another venue for challenging the importation of grey goods. The US Supreme Court in *Quality King Distributors, Inc v L'anza Research International, Inc*, 118 US 1125 (1998) held that a US copyright owner's right to prevent unauthorized importation of a copyrighted good made in the United States is extinguished upon the first sale of that good (referred to as the first-sale doctrine). However, the Supreme Court excluded from this ruling goods lawfully manufactured in another country.

Canadian courts have taken a similar stance. Several Canadian courts held that importing goods lawfully manufactured and sold outside Canada infringes the rights of the Canadian copyright holder (*Clarke, Irwin & Co Ltd v C Cole & Co Ltd*, [1960] OR 117 (Ont HC); *Fly by Night Music Co Ltd v Record Warehouse Ltd* (1975), 20 CPR (2d) 263). Indeed, the Canadian Copyright Act expressly forbids parallel importation of books, works, sound recordings, and communication signals. However, if only a minor portion of a product is copyrightable (a small part of the packaging, for example), infringement of that copyright may not persuade the courts to bar the importation of the infringing product.

In conclusion, although resisting grey products through trade mark law seems attractive, such a path provides limited recourse. To benefit from the protections offered by trade mark law, corporations must plan ahead and obtain Canadian trade marks through their Canadian subsidiaries. Other venues such as patents, copyrights, and regulatory actions may also provide viable protection against grey market goods, and, if available, may even form the preferred route in place of trade mark litigation.

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