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EXPECT THE BEST

Strategies to Combat Grey Good in Canada

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Counterfeit goods have long been a concern of businesses which invest heavily in product research, development and branding with hopes of gaining market exclusivity. With the movement of manufacturing to cheaper labour markets overseas, counterfeiting has steadily increased over the last number of years. Fortunately, there may be some strategies for businesses to help prevent counterfeiting and a related problem, referred to as grey marketing.

Counterfeit goods -- "knock-off" purses and DVDs that you see on street corners, for example -- are sold on what is sometimes referred to as the "black" market. The goods in the black market are illegitimate in that they are not produced by the authorized manufacturer and they infringe on the copyright and trademark rights of the brand owner.

While most consumers are aware of the black market, fewer consumers are aware of the "grey" market. Unlike counterfeit goods, which are of inferior quality, grey goods are the real thing in that they are produced by an authorized manufacturer. However, grey goods are brought into the domestic market by unauthorized dealers. Grey goods are referred to as "grey" because their presence in the market is clouded, or "grey," in that they may infringe intellectual property rights. Because grey goods are genuine goods, the grey market presents unique challenges for businesses seeking to enforce their intellectual property rights.

An example may help illustrate the problem of grey marketing. A product, such as dolls made by Mattel, may be purchased in a foreign market at a lower price per unit than the same dolls are sold for in Canada. An entrepreneur can travel to that foreign market, buy a supply of the dolls manufactured in that market, and import them into Canada. The entrepreneur can then sell the dolls in Canada at a price that is lower than the price that the authorized seller charges here. As a result, the brand owner loses sales that would otherwise be available to him.

Another potential problem is that once grey market goods enter the domestic market, they can become mixed with fakes sold on the black market, making it difficult to distinguish between the two types of goods. Finally, grey goods may not come with the same warranty as the genuine goods sold by the authorized manufacturer or distributor.

Fortunately, there are prevention and enforcement strategies that can be used to combat grey marketing.

As a pre-emptive measure against grey marketing, business owners should carefully draft and review supply and distribution agreements. Provisions that may be desirable include:

- Territorial restriction clauses: These clauses restrict the distribution of products by any purchaser to the domestic market where the purchaser is located.
- Quota restriction clauses: These clauses place limits on the amount of the products being supplied so as to meet domestic demand
- Export price clauses: These clauses can be drafted to impose a minimum price on any product that is sold outside of the domestic market
- Liquidated damages clauses. These clauses require the payment of a pre-determined amount of damages in the event that the goods sold to the distributor are found in an unauthorized market.

Once an authorized manufacturer or distributor becomes aware that grey marketing is occurring, there may be mechanisms available under trademark law and copyright law that may help stop the grey marketing.

Section 19 of the *Trademarks Act* provides that the owner of a valid Canadian trademark registration has the exclusive right to use the trademark throughout Canada in association with the wares for which the trademark is registered. Accordingly, an infringement action could be brought against an unauthorized dealer if the product bears the registered trademark belonging to an owner. For this ground to succeed, Canadian courts have imposed the requirement that the unauthorized product must have characteristics that are distinct from the Canadian product.

Even if an owner does not have a registered trademark, an action for "passing off" can be brought. For a passing-off action to succeed, there has to be a misrepresentation to the public, made in the course of trade, which is calculated to injure the business or goodwill of another trader. Canadian courts have restricted the application of passing-off, partially because of the doctrine of exhaustion. According to this doctrine, once "legitimate" goods are sold into the marketplace anywhere in the world, there can be no further restriction on their physical transfer by the assertion of intellectual property rights that reside in the goods.

Section 27(2) of the *Copyright Act* provides that it is an infringement for a person to import into Canada a copy of a work that the person should have known infringes copyright, or would infringe copyright, if it had been made in Canada. For example, products are often imported into Canada with labels having artwork. An unauthorized dealer who adapted the artwork could be found liable for copyright infringement. To rely on this provision, the owner of the copyrighted work would have to establish that (i) the genuine article's text or artwork is sufficiently original to attract copyright protection; (ii) that it is the owner of the non-expired copyright; and (iii) that the work was imported for the purposes of selling, renting, distributing, or any other activity that would constitute infringement.

Canadian courts have not traditionally been supportive in the use of trademark law and copyright law to prevent grey marketing of goods. However, in the right circumstances, these legal mechanisms can provide recourse to manufacturers and authorized distributors. Further, manufacturers should be proactive in controlling the distribution of their goods through authorized channels to prevent the problems associated with grey marketing. ■