

Gray Market Presents Legal Challenge for Brands

By Liza Casabona

Gray-market goods can destroy a brand, ruin markets and weaken retail relationships. Yet apparel and accessories manufacturers have little legal recourse when it comes to the sale of gray goods, exposing flaws in today's distribution system and intellectual property protection efforts.

Sometimes called parallel imports, gray goods are legitimate products that are distributed through channels not authorized by their original manufacturer. The products, intended for sale outside the U.S., are often sold Stateside — and at lower price points. An authentic designer handbag manufactured for distribution in Europe, for example, is considered "gray" if it is sold in the U.S. instead.

"The problem of stopping gray-market goods in the apparel area is almost impossible," said Brian Brokate, partner, Gibney, Anthony & Flaherty.

Under current legal statutes, gray-market items are only illegal if there is a material difference between the items being brought in from abroad and those manufactured for distribution here. In the apparel and accessories businesses, though, products may be identical worldwide, a situation

that lends them to being sold in unintended markets. While gray-market products hardly seem as damaging to a brand as counterfeit goods, the blurry legal lines translate into a field day for discounters as well as an erosion of a brand's equity.

While technically a legal source of designer goods for off-price retailers such as

"When those [luxury] goods are marketed in the off-price stores, that undercuts the cachet that the brand has developed. So it undercuts the marketing, it undercuts their ability to extract a premium price. Of course, it's the premium price in the U.S. that's creating the opportunity anyway," Dunne said.

Pricing isn't the only issue. If

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— Ed Haddad, New Balance

Marshall's, TJ Maxx and Annie Sez, luxury brands hardly want their products in stores where they have no control over merchandising or pricing.

Luxury brands that charge premium prices for their goods don't want their products in discount stores, said Gerard Dunne, a lawyer who has represented both discounters and major brands in gray-market litigation, but now primarily represents discounters such as Annie Sez.

any given market has an influx of gray goods, authorized, full-price retailers such as boutiques and department stores have little reason to continue selling the identical goods.

"Gray goods can ruin someone's market. Your authorized retailers get angry and stop dealing with you because you're not controlling how your goods are sold. It can [lead to] discounting and can really do damage to a brand," said Ed Haddad, vice

president of intellectual property and licensing at New Balance.

From a consumer standpoint, gray-market goods are a seemingly legitimate source for branded goods. "People have an expectation of finding bargains, of going to a Filene's Basement or a Marshall's or a similar discounter and finding product there. How that product gets there or how it's labeled, they don't really care. They just see the fact that the product is at a price that they can afford," said Angelo Mazza, partner, Gibney, Anthony & Flaherty.

However, gray-market goods can cause problems for vendors and consumers, especially in cases where legitimate gray-market goods are mixed in with counterfeit products. The flood of gray-market goods can also weaken sanctions against counterfeits, said Mazza.

Counterfeit enforcement is already a complicated and difficult fight. Gray-market goods muddy the water further by increasing the volume of "questionable" shipments and posing some sticky challenges in relation to customs.

For example, if a buyer for an off-price retailer ships a container of gray-market designer branded handbags to the U.S., Customs inspectors may initially think it is a shipment of counterfeit goods due to the size of the shipment, usually a red flag for counterfeits. But once assured that many of these shipments are of authentic goods, Customs may start easing their inspections of branded products, and in effect, expose the market to more counterfeit goods than ever before.

"A lot of times, Customs will stop shipments and then try to get information from companies about whether it is counterfeit or gray market and whether it should be seized or let into the country," said Heather McDonald, partner with the law firm Baker Hostetler. Counterfeits, which generate

\$600 billion in global sales, are so pervasive today that it can be nearly impossible to distinguish between the two kinds of products, according to industry sources.

With few avenues for legal action against the distribution of gray-market goods, branded companies will sometimes file trademark infringement lawsuits claiming that goods are counterfeit when they are really gray market, Dunne said.

This results in a frenzy of lawsuits, even when there has been no crime. From the seller or importer's perspective, while they are legally within their rights, defending a lawsuit is costly. Often companies that are sued will back down because their investment in the goods is less than the cost of a lawsuit.

"It's a perfectly legal trade, it can't be stopped legally, but people can be intimidated by lawsuits of counterfeiting," Dunne said. Few retailers want to be tainted by accusations of counterfeiting in today's market.

Annie Sez, which is operated by Big M, has been sued by several luxury brands in recent years, including Polo Ralph Lauren, Gucci and Fendi A&E Srl for alleged trademark violations. Recent lawsuits filed against discounters like Wal-Mart and Target by brands like Fendi and Coach could also be connected to the purchase of gray goods.

A lot of the gray-market problem for apparel companies in the U.S. stems from weaknesses in the policing of the overseas distribution system. It is important to have control over foreign licensees and retailers in particular, sources said. Companies with overseas manufacturing and distribution need to think about placing restrictions on those entities regarding bulk sales of products and how product is distributed and disposed of in general, sources said.

— With contributions from
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