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Insights: Alert

Using Trademark Law to Fight Price Gouging: Beware the Exhaustion Doctrine

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On April 10, 2020, 3M Company, a well-known manufacturer of scientific and medical products, became one of the first companies to file a lawsuit alleging trademark infringement, likely dilution, and false advertising arising from alleged price gouging during the COVID-19 pandemic.[1] This case raises a number of issues associated with the use of trademark law to combat pandemic-inspired price gouging schemes. The most significant of these is the applicability of the first-sale, or exhaustion, doctrine, which limits the ability of trademark owners to challenge the resale of their own products. This alert addresses the significance of that doctrine and strategies trademark owners can use to ameliorate the doctrine's effects in lawsuits against price gouging associated with their own goods.

3M's Lawsuit

3M has accused the defendant, Performance Supply, LLC, of engaging in a false and deceptive price gouging scheme that improperly uses and trades upon the goodwill of 3M's trademarks. Specifically, it alleges that Performance Supply submitted a bid to New York City's Office of Citywide Procurement and offered to sell 3M-branded N95 respirator masks to the city at prices 500-600% above 3M's list price. The Office of Citywide Procurement accepted the bid to secure the critically needed N95 masks, agreeing to pay nearly $45 million for them. On Friday, April 24, 2020, the United States District Court for the Southern District of New York entered a temporary restraining order (TRO) against Performance Supply's conduct and scheduled a briefing hearing on whether to convert the TRO into a preliminary injunction.

The Exhaustion Problem

Potential plaintiffs inclined to follow 3M's lead should keep in mind that the relief it has received so far is relatively unusual in cases in which trademark owners seek to regulate downstream sales of their own goods. In particular, if a plaintiff has authorized the release of goods bearing its mark into commerce, it will have to contend with the "exhaustion," or "first sale," doctrine if it seeks to use trademark law as a mechanism to challenge the circumstances under which those goods are resold.[4] As one court has explained:

> Under this doctrine . . . a markholder may no longer control branded goods after releasing them into the stream of commerce. After the first sale, the [mark]holder's control is deemed exhausted. Down-the-line retailers are free to display and advertise the branded goods. Secondhand dealers may advertise the branded merchandise for resale in competition with the sales of the markholder (so long as they do not mis-represent them¬selves as authorized agents).[5]

The doctrine therefore protects resellers and licensees from being liable, for example, for selling a mark owner's goods for what the mark owner considers too low or too high of a price. This also prevents mark owners from simply saying, "I disapprove of the defendant's resale of my goods." Nevertheless, mark owners may avail themselves of several recognized exceptions to this doctrine, provided they plead them carefully and are prepared to adduce the evidence and testimony necessary to establish the exceptions' applicability at the proof stage of litigation to protect their marks.

First, an exception exists if a defendant has repackaged the plaintiff's goods without adequately disclosing the repackaging to consumers. Thus, for example, in *Enesco Corp. v. Price/Costco*,[6] the Ninth Circuit reversed the grant of a motion to dismiss for failure to state a claim after noting allegations in the plaintiff's complaint that the defendant had failed adequately to disclose its repackaging of the plaintiff's goods. [7]

A second exception applies if the diverted goods are materially different from their authorized counterparts.[8] This usually requires a showing of a physical difference,[9] but the absence of warranty protection for the resold good also can be material.[10] Likewise, the removal of product codes used

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to track goods for quality-control purposes can render the resale of an otherwise genuine good actionable.[11] Whatever the alleged difference may be, the standard for a finding of materiality is low.[12]

A third exception applies if the diversion of a plaintiff's product from the plaintiff's authorized channels of distribution results in the product no longer being subject to the plaintiff's quality-control procedures. Under this exception:

> "[Q]uality control" is not a talisman the mere utterance of which entitles the trademark owner to judgment. Rather, the test is whether the quality control procedures established by the trademark owner are likely to result in differences between the products such that consumer confusion regarding the sponsorship of the products could injure the trademark owner's goodwill. [13]

Consequently, to assert trademark infringement under this theory, the mark owner must establish "(i) it has established legitimate, substantial, and nonpretextual quality control procedures, (ii) it abides by these procedures, and (iii) the non-conforming sales will diminish the value of the mark."[14] The procedures at issue need not be "the most stringent measures possible" to trigger this exception; [15] nevertheless, their existence must be pleaded and ultimately proven.

A fourth recognized exception applies when the resold goods differ so fundamentally from their authorized counterparts that no amount of disclosure can cure potential confusion over whether the goods are authorized.[16] This exception can apply if, for example, a once-genuine good has been so refurbished that it is unfair to describe it as originating with the owner of the mark appearing on it.[17]

Finally, a fifth exception holds if a defendant has committed independent acts of deception in the reselling process. As one court has explained:

> [T]he [first sale] doctrine is not available to uses that create confusion beyond mere resale. . . . Any conduct beyond mere resale triggers liability. For example, active or purposeful deception, false suggestion, or misrepresentation on the part of a reseller, designed or likely to cause confusion about whether or not the reseller is an authorized dealer.[18]

Thus, "the first sale doctrine does not protect resellers who use [plaintiffs'] trademarks to give the impression that they are favored or authorized dealers for a product when in fact they are not."[19]

Conclusion

A plaintiff seeking to use trademark law to block sales of its own goods at pandemic-related inflated prices faces a serious obstacle in the form of the exhaustion doctrine. Pursuant to that doctrine, an objection to the circumstances under which branded goods are resold is not in and of itself a basis for a finding of liability. Nevertheless, exceptions to that doctrine exist and can form the basis for injunctive, and possibly even monetary, relief. A mark owner wishing to follow 3M's lead therefore should give careful consideration as to how to phrase its claims so they qualify for one or more of the exceptions. A failure to do so could lead to the summary disposal of its case, whether at the pleadings stage, or on summary judgment.

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[1] 3M Co. v. Performance Supply, LLC, No. 1:20-cv-02949-LAP (S.D.N.Y. Apr. 10, 2020). 3M followed its filing in the Southern District of New York with substantively identical suits in California, Florida, and Texas.

[2] *Id*.

[3] *Id.*

[4] "[T]he general rule that a distributor who resells branded goods without change is not an 'infringer' and thus needs no 'license'." J. Thomas McCarthy, 4 *McCarthy on Trademarks and Unfair Competition* § 25:41 (5th ed.) ("*McCarthy*"). The exhaustion doctrine does not apply if the goods in question were not released into the stream of commerce under the authority of the owner of the trademark appearing on them. *See, e.g.*, By Design PLC v. Ben Elias Indus., 49 U.S.P.Q.2d 1789, 1791-93 (S.D.N.Y. 1998) (rejecting doctrine's applicability in case in which plaintiff had rejected goods in question, only to have them surface in defendants' possession).

[5] Osawa & Co. v. B & H Photo, 589 F. Supp. 1163, 1173-74 (S.D.N.Y. 1984) (citations omitted).

[6] 146 F.3d 1083 (9th Cir. 1998).

[7] *Id*. at 1085-86.

[8] "Thus, the first sale rule does not apply when the goods are altered so as to be materially different." McCarthy, *supra* note 4, § 25:41.

[9] *See*, *e.g*., Societe des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F.2d 633, 635 (1st Cir. 1992) (differing caloric content of resold mints).

[10] *See*, *e.g*., Beltronics USA, Inc. v. Midwest Inventory Distrib. LLC, 562 F.3d 1067, 1074-76 (10th Cir. 2009) (affirming finding of liability based on failure to disclose lack of warranty protection covering altered good).

[11] *See* Zino Davidoff SA v. CVS Corp., 571 F.3d 238, 246 (2d Cir. 2009).

[12] *See*, *e.g*., *id*. (referring to "low" standard).

[13] Iberia Foods Corp. v. Romeo, 150 F.3d 298, 306 (citations omitted).

[14] Warner-Lambert Co. v. Northside Dev. Corp., 86 F.3d 3, 6 (2d Cir. 1996).

[15] Mary Kay, Inc. v. Weber, 661 F. Supp. 2d 632, 643 (N.D. Tex. 2009).

[16] *See* Metropcs Wireless, Inc. v. Virgin Mobile USA, L.P., No. 3:08-CV-1658-D, 2009 WL 3075205, at *4 (N.D. Tex. Sept. 25, 2009) ("[A]t least in the context of the sale of repaired or altered goods that still bear their original trademark, if it is deceptive to retain the trademark because the product is, after extensive repairs or alterations, essentially a new product, then the original trademark must be removed from the repaired or altered good.").

[17] *See e.g*., Cartier v. Aaron Faber, Inc., 396 F. Supp. 2d 356, 360 (S.D.N.Y. 2005) (reaching finding of counterfeiting based on showing that "[t]he [defendants'] alteration of the [plaintiffs'] watches is so extensive as to have significantly changed the design of the original product and to have compromised the core functions of the watch").

[18] Caterpillar Inc. v. Telescan Techs., L.L.C., No. CIV.A. 00-1111, 2002 WL 1301304, at *5 (C.D. Ill. Feb. 13, 2002); see also Enesco Corp. v. K's Merch. Mart Inc., 56 U.S.P.Q.2d 1583, 1593 (N.D. Ill. 2000) (denying defense motion for summary judgment on ground that first-sale doctrine protects resellers from liability for infringement when use of the trademark is only "incidental to permissible resale and accompanying advertisement of trademarked products" and does not extend to uses that "create confusion beyond mere resale").

[19] Australian Gold, Inc. v. Hatfield, 436 F.3d 1228, 1241 (10th Cir. 2006).

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