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Circuit to Decide Who Should Monitor Online Counterfeiters

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Oral arguments will soon be heard by the U.S. Court of Appeals for the Second Circuit in the highly-watched dispute between renowned jeweler Tiffany & Co. and eBay, the popular online auction site, over who bears the burden of "policing" online counterfeit activity.

Evidencing the tension between e-commerce and brand owners, eBay, Tiffany, and several amici curiae have advanced their positions to the circuit. This article summarizes some of the arguments.

The U.S. Supreme Court holding in [Inwood v. Ives](#) renders a third-party liable if it "intentionally induces another to infringe a trademark or if it continues to supply its product to one whom it knows or has reason to know is engaging in trademark infringement."¹

Tiffany claimed eBay encouraged sellers to use the "hot" Tiffany search term and earned a percentage commission from counterfeit sales. This "symbiotic relationship," argued Tiffany, combined with eBay's knowledge, supported liability under *Inwood* and cases such as [Hard Rock Café Licensing Corp. v. Concession Servs. Inc.](#) and [Fonovisa Inc. v. Cherry Auction](#).²

Tiffany and other brand owners argue that eBay's "notice-and-takedown" procedure - removing suspicious listings after notification through eBay's Verified Rights Owner (VeRO) program - is inadequate and that eBay must be proactive in screening for counterfeit items and ban infringers.

The auction site denied any duty to act absent specific notice of infringing listings. The site distinguished itself from Napster, the music-sharing Web site found liable for its users' copyright infringement, by arguing that it did not "learn of specific infringing material [. . .] and fail[] to purge such material."³

The District Court agreed that eBay always removed specific listings in response to notice, and that Tiffany's must provide eBay with that information. But eBay refused to pre-screen and remove suspicious listings or automatically suspend violators.

[The court found](#) that eBay both provided and controlled the necessary marketplace used for counterfeiting but concluded eBay had only "general" knowledge of counterfeit Tiffany sales and did not continue to supply its services "to one" it knew to be infringing, all of which it found insufficient to impose an affirmative duty to remedy the problem.

The court's test became: "whether eBay continued to provide its website to sellers when eBay knew or had



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reason to know that those sellers were using the website to traffic in counterfeit Tiffany jewelry."⁴

On appeal, Tiffany argues that *Inwood* mandates liability if a provider "knows" or has "reason to know" that its product or service is being used for infringement. Tiffany argues that this "false distinction" between "general" and "specific" knowledge resulted in an erroneous interpretation of the word "one" in the *Inwood* standard as a specific person rather than the equally permissible definition of "any person indefinitely; anyone." Tiffany insists that, at a minimum, general knowledge of pervasive counterfeit sales triggers a duty to investigate.

The International Anti-Counterfeiting Coalition (IACC) agreed with Tiffany that this distinction "eliminates the universally accepted constructive knowledge standard and eviscerates the well-settled rule that one cannot avoid contributory infringement liability through willful blindness to prevalent third-party misconduct."

This, argues the IACC, "held that Tiffany's duty to police its marks absolved eBay of responsibility for the widespread infringement and counterfeiting on its site." While relevant to "strength of the mark," Tiffany's policing efforts are irrelevant to eBay's liability and its own efforts to prevent counterfeit sales.⁵

The cosmetics and fragrance manufacturer, Coty Inc., filed an amicus brief with the Second Circuit in which it stated that the volume of specific notices of counterfeits to eBay also provided generalized knowledge of a greater universe of counterfeit sales.⁶ This, argued Coty, imposed a duty of further investigation and action due to its "conscious avoidance of learning the truth when one is on notice of a high probability of an incriminating fact."

The Coty brief urged the court to reaffirm that this "willful blindness is equivalent to actual knowledge for purposes of the Lanham Act" and that "knowledge can be imputed to a party who knows of a high probability of illegal conduct and purposefully contrives to avoid learning of it."⁷

As noted by IACC and Coty, the court found that the following conclusions supported liability: eBay's failure to separately investigate the extent of counterfeit jewelry or track suspended sellers of counterfeit Tiffany items, the increase in Tiffany's notices (20,000 in 2003 to 135,000 in 2006), and eBay's active steps to grow Tiffany sales on eBay despite the voluminous availability of counterfeit Tiffany items without considering its contribution to the problem.

Yet, the court departed from these findings to excuse eBay because of its notice-and-takedown procedures, even though eBay remained "blind" to listings where specific notice was not given and eBay refused to act further.

Coty analogized the situation to a bank's liability for refusing to investigate repeated notice that half of its customers' wire transfers were illegal, and failed to take affirmative steps "to prevent further money laundering on the ground that it did not know which 50 percent of the transfers was illegal."⁸

General Versus Specific

In response, eBay and the internet amici distinguish "general" from "specific" knowledge and insist that liability requires the latter. The auction site echoes the court's emphasis that contributory liability under *Inwood* requires a continued supply of services to "one whom [it] knows or has reason to know is engaging in trademark infringement."⁹

The auction site aligns "general" knowledge with the "reasonable anticipation" standard it claims was expressly rejected by *Inwood* and post-*Inwood* cases, arguing that it has no legal duty to affirmatively seek and prevent infringement.¹⁰

These Internet companies also distance eBay from the defendants in *Hard Rock* and *Fonovisa*, which validated claims against flea-market operators who, respectively, blinded itself to specific vendors it witnessed selling cheap, low-quality T-shirts with cut labels (*Hard Rock*), and who failed to reprimand counterfeit vendors, even though they physically observed and could inspect the vendors' goods (*Fonovisa*).

They also contrast eBay's active policing through VeRO and other anti-fraud efforts and routine removal of listings once specifically notified.

The Electronic Frontier Foundation (EFF) reaches even further, arguing that *Inwood* is entirely inapplicable because eBay does not possess or access the goods and lacks the ability to discern infringements.

The dispute regarding "knowledge" appears semantical. Both sides agree that *Inwood*'s "know or has reason to know" standard applies; the extant question is its interpretation. In addition to arguing that the law requires specific knowledge, eBay casts Tiffany's position as urging the restatement's "reasonable anticipation" standard. (Restatement [Third] Unfair Competition section 27, 1995).

The auction site argued that the U.S. Supreme Court rejected this type of "constructive knowledge" in *Inwood*, but IACC counter-argued that the Second Circuit previously considered, as probative of liability, that "awareness of widespread infringement was a form of evidence that satisfied the 'reason to know' standard."¹¹

Moreover, the law requires knowledge, not notice. The auction site's insistence on "specific knowledge" - i.e., notice - could be viewed as an attempt to distract from the true knowledge issue. Arguably, the record facts support a finding that eBay both fulfilled and violated its duty under either standard: despite eBay's notice-and-takedown procedure, it shielded itself from further investigating the scope of counterfeiting beyond what Tiffany alerted it to.

The court will have to determine whether eBay's affirmative steps on one side of the equation absolves its simultaneously accruing liability on the other.

Burden Shifting

Although it claimed to "leave open" the question of who can better monitor counterfeiting online, the district court answered that very question by imposing the burden on Tiffany.

Tiffany argues on appeal that this "erroneously balanced what eBay did and did not do against what Tiffany did and did not do to protect its marks," and that the proper focus is the defendant's knowledge, not plaintiff's action or inaction. Coty (supported by Tiffany and the Council of Fashion Designers of America) argued that this erroneously "subtracted the effects of Tiffany's policing effort from the high level of counterfeiting on eBay," creating an inappropriate defense to illegal behavior by "canceling out" eBay's legal duty to prevent recurrences of widespread counterfeiting.¹²

Tiffany argues that eBay is best equipped to use technology to pre-screen, delay and remove potentially infringing listings, but that eBay relies primarily on VeRO despite brand owners' complaints of its ineffectiveness.

According to Tiffany, eBay regularly allowed its sellers to offer thousands of counterfeit Tiffany items at any time, despite knowledge of the growing problem since at least 2003. Tiffany argues that the ruling thus "favors the party that has profited from facilitating the fraud and disfavors the two groups of victims that the trademark law is designed to protect," specifically, consumers and trademark owners.

This, the Council of Fashion Designers of America says, is daunting for all brands but particularly devastating to smaller companies, who cannot afford the staff or monetary resources necessary to satisfy the court's burden and would be forced out of business while counterfeiters continue to reap financial windfalls.

The council urges the circuit court to place the policing burden not on the victims but on the company creating, maintaining, and profiting from the problem.

Other interested Internet businesses in turn argue that a burden on them would cripple e-commerce and create "impracticable burdens" and "uncertainty" as to how much "generalized knowledge" would trigger a duty to act.¹³

They ask how much notice - 5 percent of items identified? - would be necessary to consider "generalized knowledge" to have been acquired. Some (eBay, EFF, and Yahoo!) argued that their business models would collapse because they lack access to inspect the physical goods, and brand owners acknowledge specialized training is required to identify counterfeit products.¹⁴

Absent the ability to physically inspect, the other Internet businesses argued that any policing burden on them would require using over-inclusive search criteria that might curtail some counterfeit listings while also excluding legitimate ones.¹⁵

Amazon.com added that Tiffany's proposal to ban listings containing "5 or more" items as per se counterfeit would be inappropriate for less costly items of other brand owners that are often sold in bulk.¹⁶ The e-commerce briefs argued that they would each need to tailor search criteria to "red flag" counterfeits of countless trademark owners with a counterfeit problem.¹⁷

This, they argue, would limit consumer choice and destroy the legitimate secondary goods market, rewarding Tiffany by eliminating competition from the secondary market and suppressing legitimate sales in order to defeat some illegal ones.

Burden Sharing

The appeal will undoubtedly impact the future of e-commerce with respect to trademark law. The court cannot avoid considering the practicalities of the situation in trying to resolve the legal issue of not only who should bear the burden of monitoring for illegal counterfeits but how it can be accomplished.

Since neither Tiffany nor eBay can single-handedly solve the problem, the practical solution is burden sharing, not shifting. Leaving aside eBay's ultimate liability for its prior actions, a burden-sharing scenario requires eBay to monitor - with the brand owners' assistance.

Prior attempts were both unsatisfactory and insufficient in this regard. eBay's primary access to listings enables it to pull listings bearing certain indicia of counterfeit (i.e., keywords, number of items, low-starting prices, high-selling completion rates, negative feedback, identical text), all of which can be narrowly tailored to particular brands, and place them in a temporary "hold" pending investigation by both eBay and Tiffany.

Tiffany would then be required to review the listings and notify eBay as to whether the goods are counterfeit or whether further investigation is needed. Any listings on which Tiffany takes no action could then be posted, without waiving further rights to later notify eBay.¹⁸

In addition, eBay should be required to accompany all "Tiffany"-related postings or advertising with a

prominent disclaimer clarifying its inability to guarantee the authenticity of trademarked goods sold on eBay addresses this issue.

Despite other measures, there is no indication that eBay has implemented prominent disclaimers attached to specific Tiffany-related listings or advertising. This would help to abate counterfeiting and balance the competing concerns raised by alerting consumers at the immediate "point of sale" of the possibility that the goods are not genuine, to conduct their own investigation, and to proceed at their own risk given the high incidence of counterfeit Tiffany sold on eBay.

These types of practical and reasonable steps that eBay did not implement should be considered in any determination of how to truly distribute the burden and address the heart of the problem.

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Endnotes:

1. 456 U.S. 844, 853-854 (1982).
2. *Hard Rock Cafe Licensing Corp. v. Concession Servs. Inc.*, 955 F.2d 1143 (7th Cir. 1992); *Fonovisa Inc. v. Cherry Auction*, 76 F.3d 259 (9th Cir. 1996).
3. *A&M Records Inc. v. Napster Inc.*, 239 F.3d 1004, 1021 (9th Cir. 2001).
4. *Tiffany*, 576 F. Supp 2d at 506-508, citing *Inwood*, 46 U.S. at 854.
5. *Id.* at 22. The blogosphere reacted strongly to the district court's interpretation of *Inwood's* knowledge standard. One commentator opined, "The Second Circuit should remand for proof on this point: what has eBay done to satisfy the burden on it to avoid 'willful blindness' of the illegal activity from which it is profiting so magnificently? And in doing so, the Circuit should enunciate how that level of prevention is to be weighed when compared to eBay's overall profitability" www.likelihoodofconfusion.com/?=1728. One post asked, "What, exactly, are you expecting eBay to do?"; another replied, "Any time (sic) you do something that makes you liable for infringement, you have a legal obligation to stop doing it, not to say 'what am I supposed to do?' You're supposed to not break the law or provide resources for others to break the law, especially when in the latter case you're profiting from that activity."
6. To illustrate the volume, eBay's 2007 net revenues totaled \$7.6 billion from 84 million worldwide users and 6 million new listings daily (100 million at any given time). The District Court calculated nearly 500,000 sales of all Tiffany jewelry in five years, earning eBay over \$4.1 million. *Tiffany (NJ) Inc. v. Ebay Inc.*, 576 F. Supp. 2d 463, 581 (S.D.N.Y. 2008). Amicus Coty alleges that eBay hosts 750 new offers of Coty brands daily, resulting in nearly 15,000 complaints and warning letters over five years, including 160 letters requesting the suspension of repeat offenders. Coty brief at 5.
7. Coty brief at 13, citing, inter alia, *Hard Rock Cafe*, 955 F.2d at 1149.
8. Coty brief at 20 citing Financial Crimes Examination Network, *In re American Express International Bank*, No. 2007-1.
9. Brief of Defendant-Appellee eBay (eBay) at 34, citing *Inwood Labs. Inc. v. Ives Labs. Inc.*, 456 U.S. 844, 854 (1982).
10. eBay at 37, 41.

11. IACC at 16 citing *Ives*, 601 F.2d at 644 and *Ives*, 638 F.2d at 543.
12. *Tiffany* at 38; *CFDA* at 8-9; see also *Coty* brief at 21-22, citing *Tiffany*, 576 F. Supp. 2d at 512-513. *Coty* points out that the mark owner's duty to police its mark exists independent of the provider's duty to prevent the recurrence of counterfeiting after acquiring knowledge of a "high probability of illegal conduct," and "[t]he two duties do not offset each other." *Coty* brief at 22.
13. Brief of Amicus Curiae of Amazon.com Inc.; Google Inc.; Information Technology Association of America; Internet Commerce Coalition; Netcoalition; United States Internet Service Provider Association; and United States Telecom Association (Amazon Brief) at 10, 15.
14. eBay at 44; Yahoo! at 16; EFF at 9.
15. EFF at 4 (internal citation omitted). The district court found that "a substantial number of authentic Tiffany goods are sold on eBay, including both new and vintage silver jewelry, sometimes in lots of five or more."
16. Amazon at 13.
17. *Id.* at 13-14.
18. *Coty* claims eBay rejected its proposal to take steps similar to these concepts. *Coty* brief at 6.