UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

GUCCI AMERICA, INC. Plaintiff, v. FRONTLINE PROCESSING CORPORATION; WOODFOREST NATIONAL BANK; DURANGO MERCHANT SERVICES LLC d/b/a NATIONAL BANKCARD SYSTEMS OF DURANGO; ABC COMPANIES; and JOHN DOES, Defendants.	: : : : : : : : : : : : : x	Civil Action No. 09-6925-HB District Judge Harold Baer, Jr.

DEFENDANT DURANGO MERCHANT SERVICES' REPLY MEMORANDUM IN OPPOSITION TO PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes & Other Authorities

PRELIMINARY STATEMENT

Upon the Affidavit of Shane Kairalla dated July 31, 2010 filed herewith, Defendant Durango Merchant Services, LLC. ("Durango") submits this Memorandum in Opposition to Plaintiff Gucci America's Motion for Summary Judgment.

I. INTRODUCTION AND SUMMARY OF ARGUMENT

In this action alleging trademark infringement and counterfeiting, plaintiff Gucci America, Inc. ("Gucci") - which has already obtained a consent judgment against the actual culpable parties ("the Laurette Defendants" or "Laurette"), which operated the website "www.TheBagAddiction.com" to market and sell allegedly counterfeit or otherwise infringing Gucci handbags - seeks to extend liability into territory where no court has previously ventured. Specifically, Gucci seeks to impose responsibility on Durango, which is not alleged to have manufactured, sold, or had any dealings in or contact with the allegedly infringing and counterfeit goods. Rather, the sole basis for the suit against Durango is an allegation that Durango acted as a broker for companies that engaged in processing credit card transactions involving the Laurette Defendants, cardholders who made purchases, and their banks, *after* the actual purchase and sale of the allegedly infringing goods was completed. As such, common sense and justice dictate that Durango should not be required to act as the "trademark police."

Gucci's claims for direct trademark infringement and counterfeiting have already been dismissed. As a matter of law, *contributory* trademark infringement requires that a company providing services to an infringer either *intentionally induced* another to infringe a trademark, or had *direct control over the instrumentality used to infringe* and continued to provide goods or services to one whom it knew, or had reason to know, was engaging in infringement. Only the inducement claim remains against Durango, but Gucci fails to prove that Durango intentionally induced infringement.

Gucci's summary judgment motion should be denied based on the absence of sufficient facts proving that Durango knew that the BagAddiction website was engaged in the sale of counterfeit Gucci products. The applicable standard for contributory infringement is *knowledge* of the infringement, not merely *suspicion* and Gucci has not proven such knowledge.

II. BACKGROUND AND FACTS

Durango acts as a referral service, or broker, to bridge retailer / merchants with entities that offer credit card processing services. (Kairalla Aff. ¶ 3).[1] Durango does not process credit transactions. (Kairalla Aff. ¶ 4). As a broker, Durango's role is to send merchant account applications to processing banks, such as Defendant Frontline Processing Corporation, for the processing banks to decide whether the accounts are acceptable. (Kairalla Aff. ¶ 3). There is no approval process from Durango, as it is not Durango's role to engage in any form of underwriting. (Kairalla Aff. ¶ 4).

With regard to this action, Defendant Frontline specifically indicated that "replica" merchant accounts were acceptable. (Kairalla Aff. ¶ 5). Durango *then* added the term "replica" to its website as part of a lengthy list of acceptable merchant account types. (Kairalla Aff. ¶ 6). In this regard, it must be noted that the marketplace is replete with perfectly legal replicas, including the sale by major retailers of sports items such as jerseys, caps, and helmets, artwork, costume jewelry, clothing, Hollywood items, military items, furniture, and a host of other products.

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1. References to "(Aff. ¶ __)" herein are to the Affidavit of Shane Kairalla dated August 1, 2010, filed herewith.

Importantly, in the standard processing agreement between the merchant and the credit card processing bank, the merchant specifically warrants "that Merchant will comply fully with all federal, state and local laws, rules and regulations applicable to its business." (**EXHIBIT A**).[2] (See also Kairalla Aff. ¶ 7). Furthermore, it must be understood that any merchant can easily change the contents of their website, without Durango's knowledge, *after* their processing account is approved. (Kairalla Aff. ¶ 8).

Contrary to Gucci's repeated assertions, Durango does not, and has never specifically solicited "replica" merchant business. (Kairalla Aff. ¶ 9). For example, Durango uses no metatags, Google "AdWords," or other search engine key words that would enable Durango to target replica merchants in particular. (Kairalla Aff. ¶ 10). In fact, upon being served with the present suit, Durango elected to stop accepting replica merchant applications altogether and even informed its network of independent agents that replica accounts were no longer acceptable. (Kairalla Aff. ¶ 11). This is in part because replica merchants comprised less than 1% of Durango's total business. (Kairalla Aff. ¶ 12). Rather, Durango, who has brokered better than 5,000 merchant accounts, far more regularly services clients who deal in travel accommodations, communications services, financial services, herbal supplements, online services, and property management and rental services, to name a few industries. (Kairalla Aff. ¶ 13).

Regarding the Laurette defendants and their BagAddiction website, Durango acted as a broker in exchange for a flat set up fee of $195.00, plus a miniscule residual percentage of sales processed by the merchant. Such amounted to a mere total of $13,544.75 in profits to Durango. (Kairalla Aff. ¶ 14).

2. References to "**EXHIBIT __**" herein are to the Declaration of Todd Wengrovsky, dated July 31, 2010.

Gucci's Summary Judgment Motion is entirely based upon the alleged facts outlined in Gucci's Preliminary Statement. However, Gucci's Statement contains a host of additional representations that are simply inaccurate, outlined as follows:

Gucci repeatedly argues that "*Durango advertised that it could help 'high risk' merchants*." Gucci's argument implies that "high risk" somehow equates to liability or unsavory practices. Durango engages in no unsavory practices, and has a stellar reputation in its field, as evidenced by its "A+" rating with the Better Business Bureau as a result of having not a single complaint filed against it. (See http://www.newmexicoandsouthwestcolorado.bbb.org/Business-Report/Durango-Merchant-Service-LLC-99123406).

As Gucci well knows, Durango does not categorize merchants as "high risk." Rather, "high risk" is a banking industry phrase that simply refers to merchants with a higher risk of customer chargebacks than other merchants, or of causing a financial loss to the processing bank if the merchant cannot financially cover chargebacks received. (Kairalla Aff. ¶ 15). For example, all e-commerce and telephone order businesses are "higher risk" than traditional "brick and mortar" stores simply because they do not physically swipe the customers' credit cards and do not obtain customers' signatures, therefore the risk of chargebacks due to fraud or fulfillment issues is greater (since the product is not delivered immediately). (Kairalla Aff. ¶ 16). Indeed, many types of business models carry higher levels of risk of chargebacks for a variety of reasons. Such include the following:

- Merchants with poor personal credit;
- Travel and travel-related services,
- Timeshare advertising,
- Credit repair services,
- Collections agencies,
- Computers and electronics sold online,
- Herbal supplements
- Software downloads,

- Calling card services,
- “Voip” or voice over Internet protocol calling services,
- Financial consulting services,
- Online jewelry stores,
- Stock tip services,
- Telemarketing services,
- Dating services,
- Merchants selling high-ticket items, i.e. goods with an average price of over $500.00;
- Merchants that sell a future deliverable product or service i.e. memberships;
- Tickets to sports, concerts, and other future events;
- merchants that were previously terminated and placed on the “Terminated Match File.”

(Kairalla Aff. ¶ 18).

Gucci also states that Durango “*intentionally induced at east twenty replica merchants to increase their sales of counterfeit merchandise…*” However, Gucci offers no support for this conclusory allegation, as no evidence of *inducement* relative to twenty other merchants has been introduced. In fact, Gucci repeatedly states that Laurette referred other merchants to Durango. This is by definition <u>not</u> “inducement,” since the merchants were <u>not</u> sought after by Durango.

Gucci then argues that “*Nathan Counley even testified that he helped replica merchants fill out application forms to set up credit card processing accounts*.” However, who physically fills out the form is of no consequence. Rather, what is significant to this summary judgment proceeding is whether Nathan Counley / Durango reviewed the merchants’ <u>*product lines*</u>. Counley and Durango most certainly <u>did not</u>, as such is outside the scope of Durango’s responsibilities. (Kairalla Aff. ¶ 18).

Further regarding “replica” accounts, Gucci incorrectly states that “*Durango insisted that these merchants disclose on their websites that their products were replicas and not genuine*.” In reality, the suggestion (not insistence) did <u>not</u> originally come from Durango (who is only a broker), but rather came from defendant *Frontline* (who was the credit card processing bank).

(Kairalla Aff. ¶ 19). Durango's relaying of such a message from Frontline to the merchant in no way proves that Durango *knew* that Laurette was counterfeiting

Though Gucci argues that Durango had previously sent an e-mail to Laurette informing the merchant that it could accept a replica account, such is not a sufficient "affirmative step" taken to induce another to infringe either. This is because the communication was without a purposeful, culpable state of mind on the part of Durango. Once again, Durango – merely a broker – was simply passing along the stated directive of Defendant Frontline.

Gucci further argues that "*Durango then visited the replica merchants' websites to confirm that the requisite 'disclaimer' was in place*." This is of no consequence. Even if true, Gucci has failed to introduce evidence that Durango reviewed the merchants' *product lines*. This is because no such evidence exists.

Gucci then makes the awkward argument that "*by reducing chargebacks, Durango helped prevent the counterfeit websites from being shut down*." First, once again, it was *Frontline* that made the suggestion of a disclaimer to reduce chargebacks. Contrary to Gucci's repeated assertion, Durango is not Frontline's (or Defendant Woodforest's) agent, as Durango has no authority to speak on such corporations' behalf or bind them contractually. Second, there is no evidence that there was a risk of the website *being shut down* due to chargebacks to begin with, thus Durango is unclear as to how Gucci can make this assertion, particularly when the goal of keeping chargebacks to a minimum is a standard objective for all e-commerce merchants. Finally with regard to "replica" accounts and Gucci's inducement claim, in perhaps their greatest distortion of the facts, Gucci refers on Page 2 to "…*applications for multiple replica merchants that explicitly stated – both on the applications and on their websites – that they were selling counterfeits*…" However, not a single application "explicitly stated" counterfeit. (Aff. ¶ 20).

Most of the relevant applications simply identified the goods as "handbags," "athleticwear," or other generic and benign product descriptors. (Aff. ¶ 21). Certain applications used the word "replica," but, as discussed in detail herein, "replica" and "counterfeit" are simply not synonyms. Indeed, Durango did not understand the terms "replica" to be synonymous with "counterfeit" or that "replica" in any way referred to unlawful activity (since the market is replete with legitimate replica products). (Kairalla Aff. ¶ 28). Durango did not suspect any wrongdoing on behalf of Laurette, and it is not Durango' job to investigate merchants and the details of their product lines – such is the responsibility of credit card processing banks such as Frontline. After a merchant is approved, Durango simply moves on to the next account (Kairalla Aff. ¶ 29).

Turning to the issue of alleged spoliation of relevant evidence, Gucci blatantly distorts the facts when it states that Durango "*shredded <u>the contents</u> of the hard drives*…" Durango did not shred <u>the full contents</u> of any hard drives – it removed only *selected files* from *certain* hard drives to insure that its clients' most sensitive personal information could not be compromised. (Kairalla Aff. ¶ 22).

Likewise, Gucci carelessly refers to "*Durango's admitted destruction of relevant documents*." This is inaccurate, as Durango <u>never</u> admitted to destroying *relevant* documents.

Finally, Gucci represents to the Court that "… *it is impossible to know precisely how many applications Durango prepared for counterfeiters specifically to delete merchant applications*" and that "*there is no way to confirm these numbers*" (regarding Durango's accounts). <u>Both representations are false</u>. Durango had already produced its voluminous "master residual reports" to Gucci, which literally itemized all merchant accounts (replica or otherwise), the banks that processed the accounts, the independent agents that referred the accounts to Durango, and the exact revenues Durango received as a result of each account.

(Kairalla Aff. ¶ 23). As such, the master residual reports were actually *better evidence* regarding the merchant accounts than the allegedly-relevant deleted applications. Furthermore, all of the numbers reflected in Durango's already-produced residual reports were perfectly corroborated by both Frontline's and Woodforest's document production, and Woodforest produced all of the merchant applications at issue. (Kairalla Aff. ¶ 24). Therefore, Gucci already possessed (at least three times over) the information that they complained was missing.

III. STATEMENT OF PERTINENT LAW

Contributory trademark infringement (and counterfeiting) is a judicially created doctrine articulated by the Supreme Court in *Inwood Laboratories, Inc. v. Ives Laboratories, Inc.*, 456 U.S. 844 (1982). As the Supreme Court held:

> [I]f a manufacturer or distributor 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, the manufacturer or distributor is contributorally responsible for any harm done as a result of the deceit.

Id. at 854. Under *Inwood*, to be liable for contributory infringement, a manufacturer or distributor must continue to supply "its product" to an infringer who it knows or has reason to know is infringing another's rights. Here, because Durango is not alleged to have supplied any products to the actual infringers (the Laurette Defendants), or to customers of the BagAddiction website, its activities are beyond the reach of the *Inwood* case.

Cases decided since *Inwood* have applied the Supreme Court's test for contributory trademark infringement to cover certain service providers, but only under well-defined circumstances. In *Hard Rock Café Licensing Corp. v. Concession Services, Inc.*, 955 F.2d 1143 (7th Cir. 1992), the Seventh Circuit noted that the *Inwood* test for contributory trademark infringement could apply to the owner of a flea market providing a "marketplace" for counterfeiters because of the legal duty owed by a landlord to control illegal activities on his or her premises. *Id.* at 1149. In *Fonovisa, Inc. v. Cherry Auction, Inc.*, 76 F.3d 259 (9th Cir. 1996), the Ninth Circuit held that a flea market could be liable for contributory trademark infringement if it supplied "the necessary marketplace" for the sale of infringing products. *Id.* at 265.

Relying on *Hard Rock Café* and *Fonovisa*, the Ninth Circuit in *Lockheed Martin Corp. v. Network Solutions, Inc.*, 194 F.3d 980 (9th Cir. 1999), articulated the requirements for charging a service organization with contributory trademark infringement under the *Inwood* test:

> *Hard Rock* and *Fonovisa* teach us that when measuring and weighing a fact pattern in the contributory infringement context without the convenient "product" mold dealt with in *Inwood Lab*., we consider the extent of control exercised by the defendant over the third party's means of infringement. *Hard Rock*, 955 F.2d at 1148-49 (noting the common-law responsibilities of a landlord regarding illegal activity on a rented premises); *see Fonovisa*, 76 F.3d at 265 (adopting *Hard Rock's* analysis). *Direct control and monitoring of the instrumentality used by a third party to infringe the plaintiff's mark permits the expansion of Inwood Lab.'s "supplies a product" requirement for contributory infringement.*

Id. at 984 (emphasis added).

In *Lockheed Martin*, Network Solutions, the registrar of Internet domain names, was held not to be a contributory infringer even though it facilitated registration by third parties of domain names that allegedly infringed the plaintiff's trademark because the infringement did not result from NSI's registration of the name, but instead from the registrant's use.

The same is true in the present case, as Laurette's infringement did not result from *Durango's brokerage* of the account, but rather from Laurette's sales. Durango did not stimulate Laurette or any other merchant to commit violations, and certainly did not convince them to counterfeit. Rather, the merchants *sought out Durango* because the merchants desired to apply for credit card processing accounts.

Even more on point here, credit card companies, affiliated banks, and data processing services that supported a company selling infringing goods over the Internet, recently were found *not* to have exercised the "direct control" over the instrumentality used to infringe, as required to hold them liable for contributory trademark infringement under *Inwood*. Specifically, in *Perfect 10, Inc. v. Visa International Service Ass'n*, 494 F.3d 788 (9th Cir. 2007), *cert. denied*, 128 S. Ct. 2871 (2008), the Ninth Circuit affirmed the dismissal of all causes of action against Visa International, MasterCard International, and several affiliated banks and data processing services, for alleged contributory trademark and copyright infringement. The defendants there had merely processed credits and debits from completed credit card transactions for Web sites alleged to infringe Perfect 10's intellectual property rights after being notified by Perfect 10 of the suspected infringement.

Perfect 10 is the only cited case that squarely addresses the potential liability of credit card processing companies for trademark infringement by their clients.[3] While Gucci tries to distinguish the goods at issue in *Perfect 10* from those at issue here, the critical involvement of the credit card processing companies in the infringing activities in, *Perfect 10* and in this case are indistinguishable. While it is true that the credit card processors in *Perfect 10* could have affected the actual infringers' ability to profit from their infringing activities, in neither case did the credit card processors have the power to stop that infringing activity or remove infringing content from the Web sites. *Perfect 10* unequivocally held that "involvement" of that kind with the infringing sales is insufficient to hold the credit card processors vicariously liable for the infringement:

> It is the websites' contracts with the *consumers* that bind the websites to provide the infringing images, not the websites' relationship with Defendants. The websites' contracts with Defendants are merely a means of settling the resulting debits and credits among the websites and the relevant consumers. We hold that Perfect 10 fails to state a claim for vicarious trademark infringement. *Id.* at 808.

3. Gucci has cited no authority that held that *a broker* in the credit card processing field could be held liable For inducement to infringe.

IV. GUCCI'S HAS FAILED TO PROVE INDUCEMENT TO INFRINGE

To state a claim for contributory counterfeiting and infringement based on intentional inducement, Gucci must allege more than knowledge of infringing activity; they must allege "purposeful, culpable expression and conduct…" *Perfect 10*, 494 F.3d at 801 (quoting *Metro-Goldwyn-Mayer Studios, Inc. v. Grokster, Ltd.*, 545 U.S. 913, 937 (2005) ("Mere knowledge of infringing potential or actual infringing uses would not be enough" for inducement liability)). In other words, active inducement would require "affirmative acts" by Durango "suggesting" or inducing the third party, Laurette, to infringe Gucci's trademarks. *See Perfect 10*, 494 F.3d at 807.

While Gucci claims that Durango - involved only in the brokerage of an account for the processing of credit card transactions for the actual infringer - actively solicited replica merchants, Gucci failed to establish that Durango induced Laurette *to infringe* -- only that they may have induced Laurette to accept their *brokerage services*.

As to Durango's knowledge, Gucci alleges that because Durango knew Laurette was selling "replicas", they must have known that Laurette was trafficking in "counterfeits." To make this point, Gucci repeatedly uses the word "counterfeit" in place of "replica." The words "replica" and "counterfeit," however, have different meanings. A "replica" is a reproduction, usually a look-alike, but not a "counterfeit" using a particular trademark. Simply stated, while every counterfeit may be a replica, the reverse is not true - every replica is *not* a counterfeit. Indeed, all of the documents cited by Gucci refer to "replicas" and not "counterfeit" goods.

Ignoring this critical difference, Gucci contends that Laurette's website explicitly disclosed Laurette to be a counterfeiter, and that Durango had direct knowledge that the website was selling only counterfeit merchandise. However, the Laurette website mentioned only "replicas" and said the products were not being sold or represented as original.

Gucci also contends that Durango was at least “willfully blind” (citing to a comment from *Hard Rock Café Licensing Corp. v. Concession Services, Inc.*, 955 F.2d 1143, 1149 (7th Cir. 1992) which held that "[t]o be willfully blind, a person must suspect wrongdoing and deliberately fail to investigate"). Here; at worst, Durango understood only that Laurette was selling “replicas”, as Laurette represented it was.

Therefore, Gucci has failed to prove that Durango: (1) knew or should have known that the Laurette website was involved in counterfeiting, and (2) continued to provide services to Laurette notwithstanding such knowledge. Gucci’s Motion for Summary Judgment supports only the notion that Durango may have had *suspicions* about the products sold on the Laurette website, not that Durango *knew* the products were counterfeit.

Gucci contends that the Laurette website discloses "*the fact that it offered Counterfeit Products*," using as support a screen from the website. However, the screen reproduced in the Gucci papers makes quite a different representation regarding the products:

> Are your handbags authentic?
>
> No, all products sold are exact mirrors
> *and not being sold or represented as original*.

(*Id.* (emphasis added).) The Laurette website actually said certain products were *not* represented to be original, so customers would *not* think they were ordering genuine Gucci products, only to receive products labeled as "Gucci," but not from Gucci, *i.e.*, counterfeits. Moreover, the website does not show the products in sufficient detail for one to see whether they contain the Gucci trademarks or are just similar style bags. In any event, Gucci has not proven that Durango saw this portion of the website in the first place. (Kairalla Aff. ¶¶ 25, 26).

Moreover, in common parlance, the word "replica" does not connote a fraud like a counterfeit. *See Webster's Third New International Dictionary* (2002):

> **replica** . . . *n -s* . . . **1 :** a reproduction, facsimile, or copy (as of a picture or statue) done by the maker of the original or under his direction **2 :** a facsimile of an original work of art

Id. at 1925.

> **counterfeit** . . . *n -s* . . . **1a** : an imitation or replica markedly close or faithful to an original and typically made to deceive for gain <The $10 bill turned out to be a ~> **b :** a close approximation likely to be confused with reality or with the genuine <that temporary ~ of fame which is publicity —Irwin Edman>

Id. at 519. Thus, referring to items as "replicas" would not necessarily convey that the Laurette website was selling counterfeits, which requires the added element of an intent to deceive.

Gucci argues on Page 7 that the Laurette Defendants' website "*openly boasted that the merchandise was not authentic, but rather were 'mirror images' of Gucci products*." Such evidence obviously supported Gucci's claim *against the Laurette Defendants*. However, there is no evidence that *Durango* ever saw this representation either.

On page 11, Gucci goes to great pains to establish that two of the thousands of Durango clients have been sued for trademark infringement. Durango was unaware of this. (Kairalla Aff. ¶ 27). Although the litigation history of a prospective merchant may be useful information for a company that engages *in underwriting and account approvals* (i.e. Frontline, who owns the merchant accounts), such is of no consequence to Durango. Once again, Durango is merely a broker and performs no underwriting or approval of accounts whatsoever. Durango does not have the resources nor the duty to review the history of any prospective merchant.

Gucci also argues that because Durango's Nathan Counley received an e-mail from client Stephanie Walker that refers to Walker having received "an e-mail" from Louis Vuitton, this somehow puts *Durango* on notice of Louis Vuitton's cease and desist demand and infringement claim against Walker. Such is simply not the case, as Walker's e-mail was ambiguous at best. Counley did not, and could not know from Walker's e-mail that Louis Vuitton was contemplating legal action against Walker, particularly since Counley worked on dozens of new leads every day. Though Counley replied to Walker's e-mail, Counley did nothing more than confirm that Walker may add another website to her merchant account without the need to open a second account. This in no way equates to knowledge of *counterfeiting*, thus it is a huge unwarranted stretch for Gucci to assume that Durango assisted Walker in "*evading a cease and desist letter*."

Gucci then cites *Cartier Int'l B.V. v. Ben-Menachem,* No. 06 Civ. 3917, 2008 WL 64005 (S.D.N.Y. Jan. 3, 2008) because in that case defendants were held liable for inducement to infringe another's trademark. However, such was under circumstances (which Gucci failed to mention) that are absolutely inapplicable to the present case. Specifically, the *Ben-Menachem* defendants in question were a married couple that at least "assisted" their teenaged sons' operation of a multi-million dollar counterfeiting ring that was operated *out of their home* and via multiple websites. Though the websites were technically registered to the teenaged sons, it was obvious from the record that their defendant parents ran the illegal operation. For example, the parents admitted to providing their children with $150,000.00 to capitalize the operation, to facilitate the mass purchase of counterfeit products from overseas factories. Furthermore, the record indicated that the parents at least "assisted" their teenaged sons in setting up multiple foreign bank accounts to run the operation. Not surprisingly, the Court found the parents to be at least contributorily liable as having induced their children to infringe.

To equate Durango's role to that of the *Ben-Menachem* parents is nothing less than absurd. The *Ben-Menachem* parents had a multi-million dollar counterfeit operation being run *out of their home*, allegedly by their *teenaged children* only. The parents admitted to capitalizing the illegal enterprise and setting up foreign bank accounts to process the operation's payments.

It made sense in the *Ben-Menachem* case to characterize the defendants' behavior as "willful blindness."

Here, Durango is a broker in the credit card processing industry that did nothing more than send an application to a processing bank on behalf of a merchant who was one thousand miles away, and with whom Durango had no prior relationship. Such application was merely one amidst thousands forwarded by Durango to processing banks such as Frontline – the party who performed due diligence and approved the account.

Nothing in the depositions of Durango's witnesses or in the remainder of the record establishes that Durango knew that Laurette was a counterfeiter. Gucci instead repeatedly engages in speculation, and does not offer "significant, probative evidence" to warrant summary judgment in their favor. *See Chanel, Inc. v. Italian Activewear of Florida,* 931 F.2d 1472, 1475 (11th Cir. 1991).

As discussed in *Monsanto Company v. Campuzano*, 206 F.Supp 2d. 1271 (S.D. Fl. 2002), "to be 'willfully blind' for liability under the Lanham Act, 15 U.S.C. §§ 1114(1)(a, b), 1125(a) 'a person must suspect wrongdoing and deliberately fail to investigate.' *See Hard Rock Cafe Licensing Corp. v. Concession Services, Inc.,* 955 F.2d 1143, 1149 (7th Cir. 1992). As the Seventh Circuit in *Hard Rock* pointed out, the doctrine of contributory liability does not impose an affirmative duty on a manufacturer or distributor to seek out and prevent violations or take precautions against the sale of counterfeit product. *See id.* The standard, rather, is 'to understand what a reasonably prudent person would understand.' *Id.*

Using the logic of the *Monsanto* Court and *Hard Rock Café* Court, there is no liability for inducement to infringe on the part of Durango because it was reasonable for Durango to assume that the merchants' business model was acceptable. This is because: (1) processing banks such as Frontline stated that the accounts were acceptable; (2) per the merchants' signed processing agreements, it is the *merchants'* responsibility to comply with all applicable laws and regulations; (3) the marketplace is replete with legal "replica" products; and (4) Durango – a broker in the credit card processing field understandably had no expertise or experience with trademark law. (Kairalla Aff. ¶ 30). Because Durango's actions were reasonable under the circumstances, they did not act with "willful blindness" and therefore can not be liable for inducement to infringe as a matter of law.

V. NO ADDITIONAL SANCTIONS FOR ALLEGED SPOILATION OF RELEVANT EVIDENCE ARE WARRANTED

The Court's July 2, 2010 Order provided that Gucci could seek further sanctions in the event that Gucci's review of Durango's hard drives revealed discovery misconduct that warranted same. In its summary judgment papers, Gucci identifies no new findings relative to file shredding, yet seeks further sanctions *anyway*. Because there have been no new developments, no further sanctions are warranted. [4]

It should be noted that throughout its brief, Gucci liberally uses phrases such as "*Durango's spoliation of relevant evidence*." However, what the Court actually determined is that Durango removed "*potentially* relevant" evidence – a distinction that certainly affects the present analysis.

Gucci then essentially re-argues its point from the June 30, 2010 Evidentiary Hearing that "*applications deleted would have included an indication of the volume of sales the merchants estimated*." Once again, Durango's "master residual reports" – which were produced to Gucci

4. Gucci originally requested a default judgment against Durango due to the alleged spoliation of relevant documents, relying on *Global Naps, Inc. v. Verizon New England*, 603 F.3d 71 (1st Cir. 2010). Gucci has since withdrawn this request and no longer even cites this First Circuit case in support of its arguments.

well prior to the Evidentiary Hearing – specifically listed such information, and all of the information was corroborated by Frontline's and Woodforest's document production.

As such, Gucci is simply not prejudiced to a degree that would require further sanctions. To the contrary, the existing sanctions sufficiently serve the interests of deterrence and insuring that Durango will not gain from any file removal activities.

In support of its claim for further sanctions, Gucci cites two cases: *Arista Records LLC. v. UseNet.com, Inc.,* 633 F.Supp 2d. 124 (S.D.N.Y. 2009) and *Residential Funding Corp. v. DeGeorge Financial Corp.,* 306 F.3d 199 (2d Cir. 2002). Neither is instructive to the present analysis, as the fact pattern of the present case differs substantially from the cited cases.

As discussed at the Evidentiary Hearing, *Arista Records* is fundamentally dissimilar to the present case because in *Aeista* the defendant <u>violated a prior Court Order</u> and had been previously sanctioned for *other* misconduct. To make matters worse, the defendant had also "*engineered the unavailability of several witnesses*." Moreover, in *Arista Records*, the defendant wiped the *entire contents* of its hard drives clean, with no information remaining.

The key factors of *Arista Records* simply do not exist here. Here, Durango only removed <u>selected files</u> for data security purposes. Not only did Durango leave the remainder of the hard drives intact, it produced over one thousand e-mails and all of its residual reports so as to not prejudice Gucci in any manner. Durango was completely honest with regard to the file shredding, and made no effort to conceal that such software was used. Durango also complied with the Court Order of July 2, 2010 and produced the hard drives to Gucci immediately upon counsel coordinating the logistics for same.

Residential Funding Corp. is not instructive to the present analysis either. In *Residential*, the defendant was <u>not</u> actually accused of destruction of evidence at all. Rather, it was accused of a failure to produce evidence that it still maintained. Specifically, the defendant was to produce print-outs of many thousands of e-mails requested by the plaintiff. Despite repeated promises to do so – *including at least one misrepresentation to the Court* - the defendant delayed for months and months and finally produced the e-mail print-outs immediately before trial, clearly prejudicing the plaintiff. The Court described the defendant's conduct as "purposeful sluggishness." Such is simply not the case here.

It should be noted that the *Residential* Court based its ruling on whether the reason given by the defendant was "implausible" or "unreasonable." Here, Durango's concerns with security and identity theft are at least "plausible" and "reasonable," especially since a host of state statutes require entities such as Durango to be extremely cautious with regard to customers' sensitive personal information.

It should also be noted that the *Residential* Court stated the following: " 'a case-by-case approach to the failure to produce evidence' was appropriate because '[s]uch failures occur along a continuum of fault – ranging from innocence through the degrees of negligence through intentionality' (citing *Reilly v. Natwest Markets Group*, 181 F.3d at 267 (quoting *Welsh v. United States*, 844 F.2d 1239, 1246 (6th Cir. 1988). It is respectfully submitted that the present case is on the low end of this spectrum due to Durango's reasonable concern with identity theft.

As previously noted, Durango forwards merchant applications for credit card processing to banks that offer same. The applications include the merchant's social security number, date of birth, bank account number, driver's license identification number, address, and other information.

Because Durango is in the financial industry, it falls within the purview of various state laws and other industry guidelines that require it to adhere to very strict procedures with regard to the security of customer information.

In fact, upon information and belief, many states now have "Security Breach Statutes" which require public disclosure of computer security breaches in which unencrypted confidential information of any resident *may have* been compromised. In the event of a breach (which is defined in California for example as "unauthorized acquisition of computerized data that compromises the security, confidentiality, or integrity of personal information maintained by the person or business"), Durango would be required to inform all of its applicant / merchants whose data may have been recoverable - even from "deleted" files - that a breach of their personal information has occurred. This would even include merchants whose accounts were never approved by the processing banks. Such could obviously spell the end of a small brokerage like Durango, and clearly needs to be avoided at all costs.

Upon information and belief, the failure to implement adequate safeguards to protect customer data may expose a financial services organization such as Durango to violations of requirements imposed by the following:

- the Gramm-Leach-Bliley Act ("GLBA");
- FTC Final Safeguards;
- Colorado Rev. Stat. 6-1-716 (the state in which Durango is located);
- Wisconsin Stat. 134.98 (the state in which Durango's sales agent Nathan Counley is located);
- California: Civil Code 1798.29 (a state in which Durango has business); and
- Payment Card Industry ("PCI") Security Standards.

(See also **EXHIBIT B**, a highly instructive March, 2006 online article from the Jones Day law firm entitled: "*Security Breach Notification Requirements: Guidelines and Securities Law Considerations*," which had been reviewed by Durango prior to purchasing the Lavasoft software). As such, Gucci's own expert even testified at the June 30, 2010 Evidentiary Hearing that file shredding software is typically used in the financial industry. Gucci's own expert further testified that anyone can purchase inexpensive software online to gain access to a computer's "deleted" but not "shredded" files.

Durango has no need to keep copies of old merchant applications and related e-mails after Durango has forwarded the applications to the credit card processing banks. This is because the banks provide Durango with "residual reports" that show all merchant account activity. As such, it is Durango's policy to delete merchant applications and it is standard practice in Durango's industry to not keep sensitive information for any longer than is necessary. (Kairalla Aff. ¶ 31).

As expressly stated in Durango's Answer to Gucci's Interrogatory Number 11 <u>dated January 29, 2010</u>, "*Durango does not generally keep records on merchants once they are set-up for more than three months due to privacy concerns.*" (See **EXHIBIT C**). As such, it is improper for Gucci to imply that Durango's practice of removing files for security purposes is a <u>*new one*</u> that was established <u>*after*</u> the Court Telephone Conference of May 19, 2010 (at which time Gucci expressed a desire to "image" Durango's hard drives).

Gucci then argues that Durango was influenced by Mrs. Counley's laptop being stolen in December, 2008, yet delayed in running the file shredding software until May, 2010. What Gucci fails to point out, however, is that Durango's purchase of the Lavasoft product was merely the most recent mechanism used in an ongoing effort to insure data security. Prior mechanisms used by Durango included requiring password access to computer operating systems, utilizing encryption software, and the purchase and installation of "Lo-Jack" for their computers. (Kairalla Aff. ¶ 32).

Finally, it should be noted that Gucci has acted with no regard for the security of merchants' personal information, and has recklessly acted in a way that can increase the risk of identity theft. Specifically, in support of its requests for sanctions against Durango, Gucci has carelessly and unnecessarily filed and distributed full copies of merchant applications which include social security numbers, bank account numbers, dates of birth, addresses, and driver's license identification numbers. Though Gucci has repeatedly complained about Durango acting too strongly with regard to data security, it is at least equally improper to act with no regard for same.

VI. CONCLUSION:

Due to the foregoing, Gucci's Motion for Summary Judgment should be denied in its entirety.

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Respectfully submitted,

/s/ Todd Wengrovsky
Todd Wengrovsky, Esq. (TW4823)
Law Offices of
Todd Wengrovsky, PLLC.
285 Southfield Road, Box 585
Calverton, NY 11933
Attorney for Durango Merchant Services