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LEGAL

As luxury adapts to pandemic, mind the legal challenges ahead

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China is the world's fastest-growing luxury market. Image credit: Retail Store Tours

By Milton Springut

The luxury goods industry experienced unprecedented upheaval in 2020, chiefly from the economic dislocation caused by the COVID-19 crisis. Over the next year or two the effects of this upheaval will continue to produce massive changes in the industry.

A recent McKinsey & Co. report, *The State of Fashion 2021*, outlines major trends that the industry will face in 2021 and suggests strategies to deal with them. The report emphasizes that companies that plan to survive and even thrive will have to adopt smart and nimble strategies.

These changes will also affect the legal side.

As the business environment evolves, legal issues that were once obscure or unheard-of now become important. Part of such an effective survival strategy is understanding what the legal trends will be and the best legal strategies to deal with them.

Increased flexibility to meet economic uncertainty

The McKinsey report notes that the COVID-19 crisis has impacted every aspect of the economy, from trade and travel to consumer behavior.

To manage this unprecedented uncertainty, McKinsey advises that companies should revamp their operating models to emphasize flexibility, faster decision-making and increased emphasis on speed in innovation.

From the legal side, this advice highlights the importance of intellectual property. One type of intellectual property often overlooked in the fashion and luxury goods industry is trade secrets.

Trade secrets are not limited only to secret formulas or high technology. *Any business information* which derives value from not being known by competitors can be protected as a trade secret. In the fast moving post-COVID world, such protection becomes imperative.

Trade secret law requires that the owner take "reasonable measures" to protect trade secrets. That principally means two things: securing agreements from employees and outsiders that commit them to maintaining confidentiality and cybersecurity.

Luxury goods companies should review both to ensure that their brilliant, confidential strategies do not get scooped up by the competition.

Diminished demand requires focus on high-performing geographic areas and product categories

The most optimistic economic outlook is a slow recovery. Unemployment and restrained spending power will be the reality for some time, diminishing demand.

McKinsey advises business to emphasize higher-performing product lines, trade channels and territories. It predicts that China and other East Asian countries will be least affected by the economic downturn, Europe the most, and the United States somewhere in between.

On the legal side, this requires luxury goods companies to ensure that all of their intellectual property rights in the high-performing areas are secure.

If East Asia is going to be an increasingly important market, then the company must review its IP portfolio trademarks, design patents, and copyrights in those countries to ensure that it is protected.

If a particular product line is central to the company's survival, then the company must ask what protects it from copyists and pirates from becoming a commodity. Do the company's trademark registrations cover this product line? If a unique design is involved, has the company secured design patent, copyright and/or trade dress protection for the design? If the "*It*" product is the company's crown jewel, then IP is the security system.

Online sales

The COVID-19 crisis has driven more retail business online. Luxury goods companies have historically been extremely reluctant to move to an online sales model, both because of brand image and concerns of counterfeiting.

Those concerns are now being swept aside by the new marketing reality.

Luxury goods companies can move online in two ways. They can sell through their own sites and perhaps sites of high-end retailers, or they can partner with large online platforms such as Amazon and Alibaba.

The former selling via their own Web site and app requires significant investment in logistics to fulfill and deliver product. The latter strategy of listing on platforms involves partnering with much larger and more powerful companies, where one's brand and image are at the mercy of a much more powerful entity.

On the legal side, those companies that choose to partner with platforms must carefully review all agreements related to the arrangement. Who will control the presentation of the brand on the platform? Will secondary market vendors be permitted to sell the branded product on the same platform? How will the platform ensure that counterfeits and other infringements are not offered on the platform?

And, most importantly, will the brand be able to back out if it finds the partnership is not working? That is exactly what Nike experienced, which at one point tried partnering with Amazon, but then left the site.

Change in venues: Retail locations will change

The McKinsey report points out that the locations where luxury goods are sold will change radically.

The travel industry appears broken, and will remain so for some time. So sales in tourist and vacation locations, and on luxury cruise lines, will be reduced to near zero.

Beyond that, many previously hot areas for luxury goods have also been severely affected. New York's Fifth Avenue and Beverly Hills' Rodeo Drive, not so long ago thriving, are now virtual ghost towns.

On the legal side, there will be an increase in disputes with landlords, as luxury goods companies attempt to get out of long-term leases.

I previously wrote about Valentino's suit against its Fifth Avenue landlord, *Valentino's Lawsuit to Cancel its Fifth Avenue Store Lease Has Consequences for Luxury Retail in New York.* There will be many more such disputes, either negotiated, or in civil or in bankruptcy court.

Luxury goods companies are well advised to assess now their needs for retail space, and review their leases for possible ways to cancel or reduce rent on such spaces.

Social justice claims: Labor and environmental

Consumers have become more aware of how workers in the supply chain are treated, and are demanding assurances that their purchases are not fueling labor exploitation.

Many are also more environmentally aware, and require confirmation that the product and its manufacture are not harming the environment.

Companies have sought to exploit this development by bragging about how their products are labor or environmentally friendly.

On the legal side, companies must beware of false and misleading advertising claims.

The Federal Trade Commission is empowered to enforce standards about advertising, and they can also be enforced by competitors in private suits under the Trademark Act, and by consumers pursuant to consumer fraud laws.

All advertising claims need to be reviewed to insulate them from any legal claims of false advertising. Such claims are reviewed in two steps.

First, what does the consumer take away from the claim? The law bans not only literally false claims, but also misleading claims. So a claim that literally means one thing, but that consumers will understand differently, can be found to be misleading, and get the company into trouble.

Second, what backup does the company have to validate the claim? If the FTC or private litigants challenge the ad, what evidence can the company produce to support its truth? This might consist of scientific research, company labor policies, agreements with suppliers or inspection of manufacturing facilities.

In any event, it is imperative that the company have this evidence in hand *before* the ad is challenged.

Inventory and supply issues

The COVID-19 crisis has also created significant supply issues for many companies, including luxury goods companies.

On the one hand, many suppliers have been unable to meet supply contracts, resulting in shortages of many products or product components. These companies are now looking to tighten their relationship with fewer, but more reliable, suppliers.

On the other hand, many companies are now stuck with large inventories of goods that sit unsold because of the depressed demand.

On the legal side, it is imperative that companies ensure the quality and authenticity of their product, and control dumping of inventory into secondary markets.

If a supplier is sitting on a large inventory of unsold product, then you can be sure that it will eventually be dumped.

Does the company want its brand sold this way? Will a flood of branded cheap products negatively affect brand image? Have these goods passed the brand owners' quality control regime which is generally what differentiates genuine from infringing goods?

In some cases, trademarks and other intellectual property rights can be used to prevent sales of the items in certain markets.

Conversely, under the first-sale doctrine of both trademark and copyright law, an authorized sale to any market can render the product genuine in other, more upscale countries.

Companies considering dumping product or authorizing dumping in certain countries should beware that if the product makes its way to another country, they may not be able to stop sales in other countries.

IN SUMMARY, the COVID-19 crisis has and will continue to force rapid and major change to the luxury goods industry.

Understanding the applicable legal principles can help companies manage this change, and survive the crisis.


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