Ottawa, Tuesday, July 28, 1998

Appeal No. AP-95-182

IN THE MATTER OF an appeal heard on November 25, 1997, under section 67 of the *Customs Act*, R.S.C. 1985, c. 1 (2nd Supp.);

AND IN THE MATTER OF decisions of the Deputy Minister of National Revenue dated August 16, 1995, with respect to requests for re-determination under section 63 of the *Customs Act*.

BETWEEN

LEEDS NECKWEAR INC. AND LEEDS INTERNATIONAL INC. **Appellants**

AND

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeal is allowed.

Charles A. Gracey
Charles A. Gracey
Presiding Member

Patricia M. Close
Patricia M. Close
Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

Michel P. Granger
Michel P. Granger
Secretary

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UNOFFICIAL SUMMARY

Appeal No. AP-95-182

LEEDS NECKWEAR INC. AND LEEDS INTERNATIONAL INC. **Appellants**

and

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

This is an appeal under section 67 of the *Customs Act* from decisions of the Deputy Minister of National Revenue under subsection 63(3) of the *Customs Act* that certain royalty payments were in respect of imported neckwear and a condition of the sale for export to Canada of the neckwear and, thus, were to be added to the price paid or payable for the imported neckwear pursuant to subparagraph 48(5)(*a*)(iv) of the *Customs Act*. The issue in this appeal is whether, pursuant to subparagraph 48(5)(*a*)(iv), certain payments made under licence agreements in respect of imported neckwear bearing certain cartoon characters were properly added to the price paid or payable for the neckwear imported into Canada.

HELD: The appeal is allowed. The Tribunal accepts that the royalties at issue were for the exclusive use and sale of neckwear bearing certain cartoon characters and the valuable intellectual property rights associated with the purchase and sale of those goods. However, the Tribunal is not persuaded by the evidence in this appeal that the licensors became, in effect, the vendors, and could have affected the appellants' ability to purchase the goods in issue from the third-party manufacturer in Italy if the appellants had not paid the royalties to the licensors.

The Tribunal finds, based on the evidence in this appeal, that there is no affiliation between the licensors, Disney and Warner, and the appellants, nor is there any ownership or affiliation between the appellants or Disney and Warner and the third-party manufacturer in Italy or its subcontractor. Moreover, the goods in issue were purchased and imported by the appellants from a third-party manufacturer in Italy or its subcontractor without any involvement of Disney and Warner, or any of its affiliates. The Tribunal is not persuaded by the evidence that there was any relationship, contractual or otherwise, between the manufacturer and the licensors which might suggest that there was some connection or relationship between the sale of the goods in issue by that manufacturer for export to the appellants in Canada and the payment of the royalties by the appellants to the licensors.

The Tribunal concludes, on the basis of its analysis of the rights and obligations created by the licence agreements, that the evidence provided is not sufficient to show that the licensors exercised any control over the manufacturer such that the appellants' ability to purchase neckwear from that manufacturer would have been restricted if the appellants had not paid the royalties to the licensors.

Place of Hearing:	Ottawa, Ontario
Date of Hearing:	November 25, 1997
Date of Decision:	July 28, 1998

Tribunal Members:	Charles A. Gracey, Presiding Member Patricia M. Close, Member Arthur B. Trudeau, Member
Counsel for the Tribunal:	Shelley Rowe
Clerk of the Tribunal:	Anne Jamieson
Appearances:	Gregory O. Somers, for the appellants Edward (Ted) Livingstone, for the respondent

Appeal No. AP-95-182

LEEDS NECKWEAR INC. AND LEEDS INTERNATIONAL INC. Appellants

and

THE DEPUTY MINISTER OF NATIONAL REVENUE Respondent

TRIBUNAL: CHARLES A. GRACEY, Presiding Member
PATRICIA M. CLOSE, Member
ARTHUR B. TRUDEAU, Member

REASONS FOR DECISION

This is an appeal under section 67 of the *Customs Act*[1] (the Act) from decisions of the Deputy Minister of National Revenue under subsection 63(3) of the Act that certain royalty payments were in respect of imported neckwear (neckties and scarves) bearing a reproduction of certain Warner Bros. Inc. (Warner) and The Walt Disney Company (Disney) cartoon characters and a condition of the sale for export to Canada of the neckwear and, thus, were to be added to the price paid or payable for the goods in issue pursuant to subparagraph 48(5)(*a*)(iv) of the Act. The issue in this appeal is whether, pursuant to subparagraph 48(5)(*a*)(iv), certain payments made under licence agreements in respect of imported neckwear bearing certain Disney and Warner cartoon characters were properly added to the price paid or payable for the goods in issue. Subparagraph 48(5)(*a*)(iv) provides as follows:

> (5)The price paid or payable in the sale of goods for export to Canada shall be adjusted
>
> (*a*) by adding thereto amounts, to the extent that each such amount is not already included in the price paid or payable for the goods, equal to
>
> (iv) royalties and licence fees, including payments for patents, trade-marks and copyrights, in respect of the goods that the purchaser of the goods must pay, directly or indirectly, as a condition of the sale of the goods for export to Canada, exclusive of charges for the right to reproduce the goods in Canada.

Mr. Al Huberts, Vice-President of Leeds Neckwear Inc. and Leeds International Inc., appeared as a witness on behalf of the appellants. Mr. Huberts described Leeds Neckwear Inc. as a necktie company involved in the manufacture and importation of neckwear distributed throughout North America. Leeds Neckwear Inc. designs neckwear, which is then produced in Italy, imported into Canada and sold to retailers throughout North America, mostly in Canada. Leeds International Inc. was to be a manufacturer of neckties in Canada, but was never really an active company.

The goods in issue are covered by two licence agreements. One of the licence agreements is between Leeds Neckwear Inc. and Disney and is dated September 29, 1992 (the Disney Agreement). In the Disney Agreement, the licensor, Disney, grants to Leeds Neckwear Inc. the right to manufacture, distribute for sale and sell silk neckties designed to retail for CAN$40 or more and silk scarves designed to retail for CAN$100 or more, bearing representations of Disney characters, in consideration for the payment of all royalties, advances and guarantees as more particularly specified. The Disney Agreement includes provisions

1. R.S.C. 1985, c. 1 (2nd Supp.).

relating to pre-production approvals by the licensor, approval of production samples by the licensor, approval of packaging, promotional material and advertising, payment to the licensor for art work done by third parties under contract, unlicensed use of licensed material, manufacture of articles by third-party manufacturers in and outside Canada, termination and rights and obligations upon expiration or termination. The provision concerning manufacture states, in part, as follows:

> (a) If you at any time desire to have Articles or components thereof containing Licensed Material manufactured by a third party, you must, as a condition to the continuation of this Agreement, notify us of the name and address of such manufacturer and the Articles or components involved and obtain our prior written permission to do so. The granting of said permission, if we are prepared to grant the same, will be conditioned upon:
>
> (i) <u>In the case of Manufacture outside the Territory</u>
>
> (1) your signing a consent agreement in a form which we will furnish to you;
>
> (2) your causing each such manufacturer and any submanufacturer to sign an agreement in a form which we will also furnish to you; and
>
> (3) our receipt of such agreements properly signed.[2]

The other licence agreement is between Leeds Neckwear Inc. and Warner and is dated October 26, 1991 (the Warner Agreement). In the Warner Agreement, the licensor, Warner, grants to Leeds Neckwear Inc. the right to manufacture, distribute and sell in Canada silk neckties[3] utilizing the names and characters of fictional cartoon characters in consideration for the payment of all royalties, advances and guarantees as more particularly specified. The Warner Agreement includes provisions relating to art work, copyright and trademark notices, approvals and quality controls, distribution and manufacture, termination by the licensor, and final statement upon termination or expiration. The Warner Agreement provides, in part, that third-party "manufacturers shall execute a letter in the form of Exhibit 1 attached [to the Warner Agreement].[4]" Exhibit 1 states, in part, as follows:

> This letter will serve as notice to you that pursuant to Paragraph 11(b) of the License Agreement dated ___________, 1992 between your client … and LEEDS NECKWEAR INC., we have been engaged as the manufacturer for LEEDS NECKWEAR INC. in connection with the manufacturer of the Licensed Product(s) as defined in the aforesaid License Agreement. We hereby acknowledge that we have received a copy and are cognizant of the terms and conditions set forth in said License Agreement and hereby agree to observe those provisions of said License Agreement which are applicable to our function as manufacturer of the Licensed Product(s). It is understood that this engagement is on a royalty free basis.[5]

Mr. Huberts described how he created designs for use on neckties using the Disney and Warner style guides, which show Disney and Warner characters in different positions, and developing different themes. He would create a rough sketch that would be sent to the manufacturer in Italy. The manufacturer's art department would then use the drawing in the sizes, proportions and colours set out in the licensors' respective style guides to create a screen. Mr. Huberts indicated that, in theory, the licensors were to approve or monitor the design process. However, because of the nature of the neckwear business and the cost

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2. Clause 24(a)(i) of the Disney Agreement.

3. An amendment to the Warner Agreement, dated November 2, 1992, provides that the licensed products include men's and women's ties, in synthetic, cotton and/or silk combinations and silk scarves.

4. Paragraph 9(b) of the Warner Agreement.

5. Appellant's Public Brief, Tab 1.

involved to produce a particular screen, and the fact that a single character could require use of several screens, each with a different colour, approval of designs by Warner and Disney was not, in the vast majority of instances, expected or required. As long as the style guide was followed, a design would be acceptable. Mr. Huberts estimated that he had five or six designs approved by the licensors. He could only recall one occasion where a design was not acceptable to a licensor and a change was required. In cross-examination, Mr. Huberts acknowledged that, although the practice was, on most occasions, not to seek approval, Warner and Disney had the right to approve or disapprove designs.

Mr. Huberts confirmed that neither the appellants nor the licensors have a relationship or affiliation with the manufacturer in Italy, or the company to which it subcontracts the production of the goods in issue. The appellants would place a purchase order with the manufacturer and were invoiced by the manufacturer, and there was written agreement between the appellants and the manufacturer or its subcontractor. Moreover, neither the manufacturer nor its subcontractor ever executed a letter in the form of Exhibit 1 pursuant to article 9 of the Warner Agreement or an agreement pursuant to article 24 of the Disney Agreement, in order to seek approval to manufacture the goods in issue. In addition, neither Warner nor Disney ever questioned the appellants concerning the approval of the manufacturer or its subcontractor.

In argument, counsel for the appellants did not dispute that the fees at issue constitute “royalties” within the meaning of subparagraph 48(5)(*a*)(iv) of the Act, nor did counsel dispute that the fees were “in respect of” the goods in issue. However, counsel disputed that the fees were paid or payable, directly or indirectly, as a condition of the sale of the goods for export to Canada. Counsel made this argument on the basis of the plain meaning of the Act, consideration of the underlying treaty, *Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade*,[6] commonly referred to as the Code, and the cases decided in jurisdictions which apply the Code, including Canada.

Counsel for the appellants submitted that there have been a number of other appeal decisions which are helpful in determining whether royalty payments are a condition of the sale for export to Canada. Counsel referred to *Signature Plaza Sport Inc.* v. *Her Majesty the Queen*[7] and submitted that, in that appeal, it was clear from the evidence that the importer could purchase the goods for export to Canada only if the royalties were paid. Counsel submitted that, since the importer purchased the recordings from the licensor itself or from its affiliates, failure to pay the royalties would have meant that the importer could not have completed the sales.

Counsel for the appellants also referred to the Tribunal’s decision in *Reebok Canada Inc., A Division of Avrecan International Inc.* v. *The Deputy Minister of National Revenue for Customs and Excise*[8] and submitted that, since the licensors had agreements with the manufacturers and, in some cases, were the actual manufacturers, the licensors could have prevented the importer from purchasing the goods in issue had the royalties not been paid. It was counsel’s view that the Federal Court of Canada - Trial Division in *Reebok Canada, a division of Avrecan International Inc.* v. *The Deputy Minister of National Revenue for*

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6. Geneva, March 1980, GATT BISD, 26th Supp. at 116.
7. 169 N.R. 321, Federal Court of Appeal, Court File No. A-453-90, February 18, 1994.
8. Appeal No. AP-92-224, September 1, 1993. Upheld by the Federal Court of Canada - Trial Division in *Reebok Canada, a division of Avrecan International Inc.* v. *The Deputy Minister of National Revenue for Customs & Excise*, unreported, Court File No. T-864-94, June 30, 1997, which is currently under appeal to the Federal Court of Appeal in Court File No. A-642-97.

Customs & Excise[9] (*Reebok-FC*), the appeal from *Reebok*, refused to find an error in the Tribunal's reasons and did not extend or restrict the law or the factors to be considered by the Tribunal in relation to a condition of sale requirement under the Act. Counsel submitted that the Federal Court of Canada - Trial Division simply paraphrased the Tribunal's findings and endorsed the Tribunal's result. Counsel referred to the following statement of the Federal Court of Canada - Trial Division, at page 9 of *Reebok-FC*, that "the royalties or fees required were clearly fees related to the exclusive use and sale of goods bearing trade-marks of value, and were payments related to the valuable intellectual property rights associated with the purchase and each sale of the goods in question" and distinguished it from the facts in this appeal on the basis that the royalty payments have absolutely no connection with the purchase of the goods.

Counsel for the appellants disagreed with the Tribunal's interpretation of the decision of the Federal Court of Canada - Trial Division in *Reebok-FC*, as set out in its recent decision in *Nike Canada Ltd.* v. *The Deputy Minister of National Revenue*.[10] In particular, counsel disagreed with the Tribunal's interpretation that the decision of the Federal Court of Canada - Trial Division in *Reebok-FC* prevented it from taking into account the actual facts surrounding the sale in considering whether a condition had been imposed on the sale of the goods for export to Canada. In counsel's view, if *Reebok-FC* were read that strictly, it would result in reading out the "condition of the sale" requirement from subparagraph 48(5)(*a*)(iv) of the Act.

Counsel for the appellants also disagreed with the application, in *Nike*, of the above interpretation of the decision in *Reebok-FC. Nike* involved related, affiliated companies sourcing goods through a reasonably complicated network of buying agency, order aggregation and indemnification payments and letters of credit. NIKE Canada Ltd. placed its order through NIKE International Ltd. and the Tribunal stated that the identity of the vendor of the goods is critical to evaluating if a royalty is a condition of the sale for export. The Tribunal noted that, in those appeals, the parties agreed that the vendor was the Asian manufacturing companies and not NIKE, Inc. The Tribunal also found that evidence relating to the issue of NIKE, Inc.'s "control" over the manufacturing process in those appeals indicated less "control" than that found in *Reebok* or in *Signature Plaza*. However, the Tribunal stated that the Federal Court of Canada - Trial Division in *Reebok-FC* did not specifically focus on such distinctions and found that, since the royalties related to the exclusive use and sale of goods bearing trademarks of value and were payments relating to the valuable intellectual property rights associated with the purchase and sale of the goods in question, they should be considered a condition of the sale for export to Canada and, thus, included in the value for duty.

In the view of counsel for the appellants, it is clear, in this appeal, that the vendor is the Italian manufacturer, which is unrelated to the appellants, and that the licensors do not exercise any control over the manufacturer. Given those facts, he argued, the royalties at issue should not be included in the value for duty of the imported goods.

Counsel for the appellants argued that the agreements in *Jana & Company* v. *The Deputy Minister of National Revenue*[11] were similar to those at issue. In *Jana*, the agreements gave a licensor the right to inspect various aspects of the design and production of the goods. None of the licensor rights in *Jana* were, in fact, consistently exercised by the licensors. As in this appeal, adherence to the agreements was in relation to the collection of royalties, not in relation to the design or production of the imported goods. In *Jana*, the

9. Unreported, Court File No. T-864-94, June 30, 1997.

10. Appeal Nos. AP-95-197 to AP-95-202 and AP-95-206 to AP-95-212, October 10, 1997. The Tribunal's decision has been appealed to the Federal Court of Appeal in Court File No. A-905-97.

11. Canadian International Trade Tribunal, Appeal No. AP-94-150, September 3, 1996.

Tribunal made a specific finding that the licensors were able to influence the manufacturers due to the volume of business that the licensors did with that manufacturer. In this appeal, the licensors and the manufacturer are not even aware of each other, and the licensors are not in a position to influence the production or other aspects of the manufacture of the goods.

In further support of his position, counsel for the appellants submitted that the Tribunal should look at Article 8 of the Code, which was in effect at the time of the imports at issue, and at the World Trade Organization *Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade 1994*[12] and consider decisions by US customs authorities[13] which apply the provisions of the Code through the domestic legislation in those jurisdictions, which is similar to that in Canada. Counsel also submitted that the Tribunal should refer to advisory opinions issued by the Technical Committee on Customs Valuation.[14]

Finally, counsel for the appellants submitted that, if the Tribunal finds the royalties to be dutiable, the duties should only apply to the royalties paid pursuant to the Warner Agreement, since those were the only royalties that were subject to the respondent's decisions.

Counsel for the respondent argued that, applying the decision of the Federal Court of Canada - Trial Division in *Reebok-FC*, the royalties at issue are a condition of the sale of the goods in issue for export to Canada and are, therefore, dutiable under subparagraph 48(5)(*a*)(iv) of the Act. Counsel submitted that, prior to *Reebok-FC*, the test applied by the Tribunal was, if the licence agreement was violated and the royalties were not paid, whether the sale of the goods by the manufacturer to the licensee could be stopped in some manner. In counsel's view, following *Reebok-FC*, this test is no longer appropriate.

In support, counsel for the respondent referred to the same excerpt in *Reebok-FC* (at page 9) referred to by counsel for the appellants and submitted that the emphasis put on the word "purchase" by counsel for the appellants was somewhat misplaced. In the view of counsel for the respondent, the property right resides in the image at the time of the purchase and sale by the appellants. The value of the image is what entitled the appellants to make sales that they otherwise would not have been able to make.

Counsel for the respondent referred to *Nike* as the first decision issued by the Tribunal subsequent to *Reebok-FC*. Counsel submitted that the Tribunal should dismiss this appeal for the same reasons as it had dismissed the appeals in *Nike*.

Alternatively, counsel for the respondent argued that, if control is still a relevant factor, control is present, as evidenced by the licence agreements at issue and the statements of the appellants' witness. Counsel submitted that the Tribunal should look at the provisions in the agreements and not at the way to which they may or may not have been adhered by the various parties. To do otherwise, counsel argued, would be to violate the parole evidence rule, which says that evidence contradicting the term of the contract should not be admissible. If words in contracts cannot be taken at their face meaning, it will create uncertainty in the commercial realm.

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12. Signed at Marrakesh on April 15, 1994.
13. United States Customs Service decisions: C.S.D. 94-2 HRL 544781, March 4, 1994, 28 Cust. B. and Dec. No. 14.; C.S.D. 94-3 HRL 544923, February 22, 1994, 28 Cust. B. and Dec. No. 14; and C.S.D. 94-5 HRL 545370, March 4, 1994, 28 Cust. B. and Dec. No. 14.
14. *GATT Agreement and Texts of the Technical Committee on Customs Valuation*, Customs Co-operation Council, Brussels. See Advisory Opinions 4.8, 4.10 and 4.13.

As evidence of control, counsel for the respondent referred to specific provisions in the licence agreements. In particular, counsel referred to articles 5 and 6 of the Disney Agreement, which provide for pre-production approvals and approval of production samples, and article 8 of the Warner Agreement, which provides that products may not be manufactured, sold or distributed without prior written consent and approval. Counsel submitted that, even if goods are not generally approved by the licensors, approval can be required and that it is irrelevant that licensors may or may not have exercised such rights. Counsel referred to the requirement under article 24 of the Disney agreement and article 9 of the Warner agreement that the appellants obtain prior written approval if using a third-party manufacturer. Counsel submitted that both licence agreements provide for approval by the licensors of the licensed goods. Finally, article 29 of the Disney Agreement and article 14 of the Warner Agreement deal with rights and obligations upon expiration or termination. In counsel's view, these articles show that, if the royalties are not paid to the licensors, the licensee may not have the licensed products manufactured, imported or sold. In terms of evidence from the witness, counsel referred to the evidence that, on several occasions, approval was sought from the licensors with respect to certain designs.

Counsel for the respondent submitted that the appellants' references to valuation decisions in other jurisdictions are of no weight and assistance in the Tribunal's application of clear statutory law in Canada.

With respect to the fact that the royalties paid pursuant to the Disney Agreement were not mentioned in the detailed adjustment statements representing the re-determinations under section 63 of the Act which are being appealed, counsel for the respondent submitted that these were clerical errors. Counsel submitted that the re-determinations under section 60 of the Act, by the admission of the appellants in their brief, were correct and named the licence agreements relevant to this appeal. In counsel's view, the Tribunal should look at the re-determinations under sections 60 and 63, and there would be no confusion about what licence agreements are at issue.

The Tribunal has reviewed its previous decisions and those of the Federal Court of Canada concerning the issue of the inclusion of royalties in the value for duty of imported goods. It is generally accepted that, in order for a payment to be dutiable under subparagraph 48(5)(*a*)(iv) of the Act, it must: (1) be a royalty or licence fee; (2) be in respect of the imported goods; and (3) be paid, directly or indirectly, as a condition of the sale of the goods for export to Canada. The appellants do not dispute that the payments are royalties or that they are "in respect of the goods." However, the appellants dispute that the royalties were paid, directly or indirectly, as a condition of the sale of the goods for export to Canada.

The issue of determining when a payment is a condition of a sale of goods for export to Canada is a controversial one and has been the subject of great debate between various importers and the Department of National Revenue. The decision in *Reebok-FC* provides some guidance on this issue and has been subsequently applied by the Tribunal in *Nike* and *Chaps Ralph Lauren, A Division of 131384 Canada Inc. and Modes Alto-Regal, Inc.* v. *The Deputy Minister of National Revenue*.[15] In *Nike* and *Chaps*, the Tribunal interpreted the general statement that the royalties "related to the exclusive use and sale of goods bearing trademarks of value and were payments relating to the valuable intellectual property rights associated with the purchase and sale of the goods in question[16]" as being the test applied by the Federal Court of Canada - Trial Division to determine whether the payment of a royalty is a condition of a sale for export. However,

15. Appeal Nos. AP-94-212 and AP-94-213, December 22, 1997. The Tribunal's decision has been appealed and cross-appealed to the Federal Court of Appeal in Court File No. A-53-98.
16. *Supra* note 10 at 10.

upon further reflection and consideration of the arguments made in the context of this appeal, the Tribunal is persuaded that this general statement must be interpreted and applied in the context of the particular facts in *Reebok-FC* and in conjunction with the additional statement of the Federal Court of Canada - Trial Division that its finding is consistent with the previous decisions in *Polygram Inc.* v. *The Deputy Minister of National Revenue for Customs and Excise*[17] and *Signature Plaza*.

In *Reebok*, with respect to one of the transactions at issue, there was a "Manufacturing Agreement" and a "Trim Manufacturing Agreement" between the manufacturers and the licensor. The Tribunal found that these facts indicated that the licensor exercised a substantial degree of control over the production of the licensed goods and that the manufacturers were only permitted to produce the licensed goods for subsidiaries of the licensor or purchasers that had been approved by the licensor. With respect to the second transaction, the licensor was both the vendor and the manufacturer. The Tribunal concluded, based on the facts relating to both transactions, that, if the appellant did not pay the royalties pursuant to the licence agreements, the appellant would not have been able to purchase the licensed goods.

In *Polygram*, the appellant imported sound recordings from foreign affiliated companies, one of which was the licensor in a licence agreement with the appellant which gave the appellant the right to promote certain music and artists and to distribute and sell sound recordings to the public. The Tribunal found that, without the signed licence agreement, which clearly sets out the appellant's obligation to pay a fee, the appellant would not have been able to purchase the sound recordings from its foreign affiliates and import them into Canada.

A review of *Signature Plaza* indicates that the Federal Court of Appeal did not merely rely on the fact that the royalties related "to the valuable intellectual property rights associated with the purchase and sale of goods in question" to find that the royalties were dutiable. Rather, the Federal Court of Appeal did "an analysis of the rights and obligations created by the agreements" and stated that this is "normally a question of mixed law and fact."[18] The Federal Court of Appeal then drew conclusions from its analysis of the rights and obligations resulting from the agreements and its understanding of the relationship between the licensor, the licensee/purchaser in Canada and the third-party manufacturers outside Canada. The Federal Court of Appeal found that the licensor, which arranged for the offshore purchase, cutting, making and trimming of fabrics by offshore plants and the delivery to the licensee/purchaser in Canada of the finished products, was, in effect, the vendor and not an agent of the licensee, as contended by the licensee. In reaching this conclusion, the Federal Court of Appeal relied, in particular, on the fact that the licensor maintained the exclusive right to produce the licensed goods. Therefore, royalties paid by the licensee/purchaser in Canada to the licensor were found to be a condition of the sale of the licensed goods for export to Canada under subparagraph 48(5)(*a*)(iv) of the Act.

The royalties paid pursuant to the Disney Agreement and Warner Agreement can be distinguished from those in *Reebok-FC*, *Polygram* and *Signature Plaza*. The Tribunal accepts that the amounts were paid for the exclusive use and sale of goods bearing certain Disney and Warner cartoon characters and the valuable intellectual property rights associated with the purchase and sale of those goods. However, the Tribunal is not persuaded by the evidence in this appeal that the licensors became, in effect, the vendors and

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17. Canadian International Trade Tribunal, Appeal Nos. AP-89-151 and AP-89-165, May 7, 1992. Leave to appeal denied, Court File No. 92-T-1967, December 18, 1992 (F.C.T.D.).
18. *Supra* note 7 at 12.

could have affected the appellants' ability to purchase the goods in issue from the third-party manufacturer in Italy if the appellants had not paid the royalties to the licensors.

In the Tribunal's view, the royalties at issue are similar to those considered and found not to be dutiable in *Jana*. In *Jana*, the royalties were paid for the right to produce, promote, sell and distribute in Canada clothing bearing certain trademarks. There was no relationship, contractual or otherwise, between the manufacturers of the clothing and the licensors to suggest that there was some connection between the sale of the clothing by those manufacturers for export to the appellant in Canada and the payment of the royalties by the appellant to the licensors. The licence agreements governing the royalties in *Jana* indicated that the licensors did maintain certain quality control rights, such as the right to inspect samples and production facilities and processes, and that the licensors may have been able to influence some manufacturers because of the concentration of business that they did with those manufacturers. However, there was evidence in that case that the licensors provided Jana & Company, not the manufacturers, with samples, designs, etc., and permitted the appellant to have the clothing manufactured by a company of its choice. Moreover, in practice, the appellant's choices of manufacturers were never questioned, and the licensors did not exercise their rights concerning inspection of facilities and samples.

In *Jana*, the Tribunal found that the evidence was not sufficient to show that the licensors exercised a substantial degree of control over the manufacturers such that Jana & Company's ability to purchase clothing from those manufacturers would be restricted if it did not pay the royalties to the licensors. Taking all of the facts into account, the Tribunal found that the royalties were, therefore, not a condition of the sale of the goods for export to Canada.

The Tribunal noted that its finding in *Jana* was consistent with Advisory Opinions 4.8 and 4.13 of the Technical Committee on Customs Valuation which, it stated, provide circumstances where the obligation to pay a royalty arises from a separate agreement unrelated to the sale for export of the goods or where the purchaser does not have to pay the royalty in order to purchase the goods are circumstances where the royalty should not be included in the value for duty of those goods.

As was the case in *Jana*, there is no affiliation between the licensors, Disney and Warner, and the appellants, nor is there any ownership or affiliation between the appellants or Disney and Warner and the third-party manufacturer in Italy or its subcontractor. Moreover, the goods in issue were purchased and imported by the appellants from a third-party manufacturer in Italy or its subcontractor without any involvement of Disney and Warner, or any of its affiliates. The Tribunal is not persuaded by the evidence that there was any relationship, contractual or otherwise, between the manufacturer and the licensors which might suggest that there was some connection or relationship between the sale of the goods in issue by that manufacturer for export to the appellants in Canada and the payment of the royalties by the appellants to the licensors.

As evidence of control by the licensors over the purchases of the goods in issue by the appellants from the manufacturer in Italy, counsel for the respondent referred to specific provisions in the licence agreements relating to pre-production, sales and distribution approvals by the licensors with respect to licensed goods, third-party manufacturers and rights and obligations upon expiration or termination. Counsel submitted that, even if goods or manufacturers are not generally approved by the licensors, approval can be required and that it is irrelevant that licensors may or may not have exercised such rights. In the Tribunal's view, it is not possible to properly determine the legal nature of the contractual relationship between the appellants and Warner and Disney based solely on the legal language used in the licence agreements. The Tribunal must conduct an analysis of the rights and obligations created by the licence agreements.[19]

With respect to the approval of designs, the evidence before the Tribunal is that the nature of the neckwear business and the cost involved to produce a particular design on a necktie were such that approval of designs by Warner and Disney was not, in the vast majority of instances, expected or required. When such approval was required or sought, it was done prior to the production of neckwear bearing the design. With respect to the approval of manufacturers, Mr. Huberts confirmed that neither the manufacturer nor its subcontractor ever executed a letter in the form of Exhibit 1 pursuant to article 9 of the Warner Agreement or an agreement pursuant to article 24 of the Disney Agreement, in order to seek approval to manufacture the goods in issue. In addition, neither Warner nor Disney ever questioned the appellants concerning the approval of the manufacturer or its subcontractor. The Tribunal is of the view that the evidence provided is not sufficient to show that the licensors exercised control over the manufacturer such that the appellants' ability to purchase the goods in issue from that manufacturer would have been restricted if the appellants had not paid the royalties to the licensors.

In view of the foregoing, the Tribunal is of the view that the fees are royalties in respect of the goods in issue. However, the fees were not required to be paid, directly or indirectly, as a condition of the sale of the neckwear for export to Canada, and the fees should not, therefore, be added to the price paid or payable for the imported neckwear pursuant to subparagraph 48(5)(*a*)(iv) of the Act.

For the foregoing reasons, the appeal is allowed.

Charles A. Gracey
Charles A. Gracey
Presiding Member

Patricia M. Close
Patricia M. Close
Member

Arthur B. Trudeau
Arthur B. Trudeau
Member

19. *Supra* note 7 at 12.