CANADIAN INTERNATIONAL TRADE TRIBUNAL
TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Ottawa, Friday, October 10, 1997

Appeal Nos. AP-95-197 to AP-95-202
and AP-95-206 to AP-95-212

IN THE MATTER OF appeals heard on February 27 and 28, 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

NIKE CANADA LTD. **Appellant**

AND

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

DECISION OF THE TRIBUNAL

The appeals are allowed in part.

Arthur B. Trudeau
Arthur B. Trudeau
Presiding Member

Dr. Patricia M. Close
Dr. Patricia M. Close
Member

Lyle M. Russell
Lyle M. Russell
Member

Michel P. Granger
Michel P. Granger
Secretary

333 Laurier Avenue West
Ottawa, Ontario K1A 0G7
(613) 990-2452 Fax (613) 990-2439

333, avenue Laurier ouest
Ottawa (Ontario) K1A 0G7
(613) 990-2452 Téléc. (613) 990-2439

UNOFFICIAL SUMMARY

Appeal Nos. AP-95-197 to AP-95-202
and AP-95-206 to AP-95-212

NIKE CANADA LTD. **Appellant**

and

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

The appellant is a wholly owned subsidiary of NIKE, Inc. It imports and sells athletic footwear, apparel and accessories under the trademark "Nike." It is licensed to distribute, sell and promote such products in Canada. The issue in these appeals is whether the royalties or licence fees paid by the appellant on the sale of the goods in issue should be included in their value for duty in accordance with subparagraph 48(5)(*a*)(iv) of the *Customs Act*, or, in other words, whether they are royalties or licence fees paid, directly or indirectly, in respect of the goods in issue as a condition of the sale of the goods for export to Canada.

HELD: The appeals are allowed in part. With respect to the Athlete Royalty payments, the Tribunal is of the view that these payments are not in respect of the goods in issue, but rather are in respect of services provided by the athletes that are not sufficiently related to the importation of the goods in issue to come within the meaning of subparagraph 48(5)(*a*)(iv) of the *Customs Act*. With respect to the royalty relating to the right to use the trademarks (the Royalty), the Tribunal notes that the Federal Court of Canada - Trial Division, in its decision in *Reebok Canada, a division of Avrecan International Inc.* v. *The Deputy Minister of National Revenue for Customs & Excise*, indicated that, as the royalties in question were 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 issue, they should be considered a condition of the sale for export to Canada and, thus, included in the value for duty. These two circumstances also apply in these appeals. Therefore, in light of this decision, the Tribunal finds that the Royalty must be considered a condition of the sale for export and, therefore, included in the value for duty of the goods in issue. Accordingly, the appeals are allowed with respect to the Athlete Royalty and are dismissed with respect to the Royalty.

Place of Hearing:	Ottawa, Ontario
Dates of Hearing:	February 27 and 28, 1997
Date of Decision:	October 10, 1997
Tribunal Members:	Arthur B. Trudeau, Presiding Member Dr. Patricia M. Close, Member Lyle M. Russell, Member
Counsel for the Tribunal:	Hugh J. Cheetham
Clerk of the Tribunal:	Anne Jamieson
Appearances:	W. Jack Millar and Dennis A. Wyslobicky, for the appellant Frederick B. Woyiwada, for the respondent

CANADIAN INTERNATIONAL TRADE TRIBUNAL | TRIBUNAL CANADIEN DU COMMERCE EXTÉRIEUR

Appeal Nos. AP-95-197 to AP-95-202
and AP-95-206 to AP-95-212

NIKE CANADA LTD. **Appellant**

and

THE DEPUTY MINISTER OF NATIONAL REVENUE **Respondent**

TRIBUNAL: ARTHUR B. TRUDEAU, Presiding Member
DR. PATRICIA M. CLOSE, Member
LYLE M. RUSSELL, Member

REASONS FOR DECISION

These are appeals pursuant to subsection 67(1) of the *Customs Act*[1] (the Act) from decisions of the Deputy Minister of National Revenue dated August 16, 1995.

The appellant is a wholly owned subsidiary of NIKE, Inc. It imports and sells athletic footwear, apparel and accessories under the trademark "NIKE." It is licensed to distribute, sell and promote such products in Canada. NIKE International Ltd. (NIKE International) is also a wholly owned subsidiary of NIKE, Inc. It processes all purchase orders for non-US distributors of NIKE products. NIKE (Ireland) Ltd. (NIKE Ireland) is a wholly owned subsidiary of NIKE International. It is the owner, among other things, of the rights to the "NIKE" name and trademark for Canada.

In 1986, the appellant entered into a licence agreement[2] (the 1986 Agreement) with NIKE Ireland to use the trademarks that it holds in connection with the manufacture, importation, promotion, distribution and sale of athletic footwear, clothing and accessories throughout Canada. In consideration of the right to use the trademarks, the appellant agreed to pay NIKE Ireland, among others things, a royalty or licence fee equal to a fixed percentage of its net invoiced sales revenues (the Royalty). The other payment in question relates to agreements which provide for various methods of payment to various professional athletes including "athlete royalty payments" for various services, including endorsing NIKE products, which are also based on a fixed percentage of net invoiced sales revenues (the Athlete Royalty).

The appellant acknowledges that, although it has the right to manufacture licensed goods, the goods in issue are goods bearing the "NIKE" trademark that were purchased from unrelated manufacturers located in Asia. Upon entry into Canada, no royalties were included in the value for duty of the goods. The subsequent review of the value for duty by the respondent resulted in a ruling that it was to include the Royalty and the Athlete Royalty.

Prior to the Tribunal's decision and reasons being issued, the Tribunal became aware of the decision of the Federal Court of Canada - Trial Division (the Federal Court) in *Reebok Canada, a division of Avrecan*

1. R.S.C. 1985, c. 1 (2nd Supp.).
2. Exhibit A-3 (protected).

333 Laurier Avenue West
Ottawa, Ontario K1A 0G7
(613) 990-2452 Fax (613) 990-2439

333, avenue Laurier ouest
Ottawa (Ontario) K1A 0G7
(613) 990-2452 Téléc. (613) 990-2439

International Inc. v. *The Deputy Minister of National Revenue for Customs & Excise*.[3] On July 22, 1997, the Tribunal wrote to both parties and indicated that it was of the view that it should consider this case in coming to a decision in these appeals. The Tribunal recognized that the parties had not had an opportunity to address the impact of the Federal Court's decision and, therefore, gave the parties the opportunity to file submissions in this regard. Both parties filed submissions in accordance with the Tribunal's directions.

The issue in these appeals is whether the two royalties or licence fees paid by the appellant on the sale of the goods in issue should be included in their value for duty in accordance with subparagraph 48(5)(*a*)(iv) of the Act or, in other words, whether they are royalties or licence fees paid, directly or indirectly, in respect of the goods in issue as a condition of the sale of those goods for export to Canada.

Subparagraph 48(5)(*a*)(iv) of the Act provides as follows:

> (5) The price paid or payable in the sale of goods for export to Canada shall be adjusted
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> (*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.

Counsel for the appellant called two witnesses who appeared as a panel. The first witness was Mr. David Kottkamp of Portland, Oregon. Mr. Kottkamp, joined the appellant in 1984 and, for a period in 1986 and 1987, he was its president. He joined NIKE International in 1987 and is currently a vice-president of the company. The second witness was Mr. Wan Jung, of Coquitlam, British Columbia. Mr. Jung joined the appellant in 1981 as an accounting manager. He was subsequently promoted to Comptroller and then to Director of Finance. He held the latter position at the time of the audit process that led to this case.

Mr. Kottkamp stated that he signed the 1986 Agreement between the appellant and NIKE Ireland on behalf of the appellant. Pursuant to this agreement, NIKE Ireland granted the appellant the right to manufacture and sell NIKE footwear, apparel and accessories in Canada. Mr. Jung stated that the Royalty to be paid under this agreement was based on a percentage of net sales and that there was a single rate for all NIKE products. As the obligation to pay the Royalty was based on sales of NIKE products, the Royalty was paid regardless of whether the products were sourced offshore or domestically.

Mr. Jung testified that, under the terms of the 1992 licence agreement[4] (the 1992 Agreement), the Royalty payments were due within one month after the goods were sold. Mr. Jung stated that the normal lead time between placing an order for imported goods and shipment to Canada is about three months and then three months again between importation and the payment of the Royalty.

Mr. Kottkamp explained that the 1992 Agreement granted the appellant the same basic rights that were granted in 1986. In his view, the provision in the 1986 Agreement and 1992 Agreement that provides that the Royalty is not payable as a condition of the sale for export to Canada is meant to demonstrate that NIKE Ireland cannot require that the Royalty be paid by the appellant before the goods subject to the

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3. Unreported, Court File No. T-864-94, June 30, 1997.
4. Appellant's confidential brief, tab 15.

agreement are sold by the appellant to its Canadian customers. He explained that NIKE, Inc. was also a party to the 1992 Agreement because it held the contracts with the athletes which included the Athlete Royalty provisions. He also explained how, under paragraph 9.1 of the 1992 Agreement, the appellant was responsible for paying the Athlete Royalty relating to the goods that it sold.

Mr. Kottkamp explained various steps in the process by which the appellant decided what goods it was going to have manufactured through to receipt of those goods for sale by its retailers. This process included picking items from a seasonal line developed by the Research, Design and Development group of NIKE, Inc., as well as having items designed for the appellant specifically. The appellant would show the various items to its retailers and then take orders. The appellant could have goods manufactured anywhere that it wished, although many of its goods were produced for it through orders made to a manufacturer through NIKE International. Mr. Kottkamp spoke of one instance when he was with the appellant when it had a shoe manufactured for it in Canada by Bata Industries Limited (Bata).

In circumstances where the appellant would order goods through NIKE International, NIKE International would aggregate orders from other NIKE companies outside the United States and forward them to NIKE, Inc. NIKE, Inc. would then aggregate US and international orders and place them with the factories that would produce the goods ordered. A copy of the order would also be given to Nissho Iwai Corporation (Nissho Iwai), which serves as financial broker for the NIKE companies and helps to process some of the paper necessary to complete the transactions. None of the factories that produce the goods nor Nissho Iwai is owned by or related to NIKE, Inc. or any other NIKE company. Under the Inter-Company Cost Sharing Agreement,[5] NIKE, Inc. provides the appellant with certain services, including production forecasting, production scheduling, factory liaison and shipping. In addition, the appellant paid for research and development assistance provided to it by NIKE, Inc. on a cost-sharing business under the Research and Development Cost Allocation Agreement[6] (the RDCAA). Mr. Jung testified that the appellant had paid duties on the applied development portion of these payments.

With respect to the pricing received by the appellant from these factories, Mr. Kottkamp stated that, taking into account volume considerations, a shoe without the NIKE trademark having the same specifications as the shoes ordered by the appellant would be priced essentially the same as the appellant’s shoes. The value of the shoes in the country of sale would, however, be different based on the value of trademarks.

Turning to the athletes’ agreements, Mr. Kottkamp testified that these agreements provide for various methods of payment to the athletes, including a base compensation, performance-based compensation and additional compensation. The appellant makes a portion of these payments to NIKE, Inc. based on sales of the NIKE products in Canada. There is no relationship between the athletes and the factories that produced goods from orders placed by NIKE, Inc. Mr. Jung stated that duty was assessed on only the Athlete Royalty and that the respondent did not assess any of the other components of the compensation paid to the athletes.

In cross-examination, Mr. Kottkamp agreed that the main purpose of the 1992 Agreement, from the appellant’s perspective, was to give it access to the NIKE trademark so that the appellant could manufacture and sell NIKE goods. He stated that he was not aware of anyone, anywhere, selling goods bearing the NIKE

5. *Ibid*. tab 18.
6. *Ibid*. tab 17.

trademark or design who had not entered into a licence agreement with either NIKE, Inc. or NIKE Ireland He agreed that paragraph 6.1 of the 1992 Agreement essentially provides that all the goods upon which the appellant pays royalties have to be produced in accordance with NIKE, Inc.'s or NIKE Ireland's specifications, though he added that goods must also be made to the appellant's standards. Mr. Kottkamp would not agree that the appellant never placed orders directly with the factories outside Canada, but rather stated that the appellant placed orders with these factories through NIKE International. In response to questions from the Tribunal, Mr. Jung stated that about 20 percent of the appellant's sales during the audit period related to clothing sourced in Canada. Mr. Kottkamp agreed that, without the 1992 Agreement, the appellant could not sell goods bearing the NIKE trademark in the Canadian market.

In argument, counsel for the appellant submitted that, in order for a payment to be added to the price paid or payable for imported goods under subparagraph 48(5)(*a*)(iv) of the Act, three requirements have to be met, namely: (i) the amount must be a royalty or licence fee, including a payment for a patent, trademark or copyright; (ii) the royalty or licence fee is "in respect of the goods"; and (iii) the purchaser must pay the amount, directly or indirectly, "as a condition of the sale of the goods for export to Canada." Counsel first addressed these requirements in the context of the Athlete Royalty and then in the context of the Royalty.

Counsel for the appellant noted that none of the trademarks licensed to the appellant were owned by any of the athletes. Counsel submitted that the payments represent part of the compensation paid to the athletes for the services that they render, e.g. personal appearances, advertisements, wearing NIKE clothing and footwear, etc. Therefore, the payments cannot be said to be "in respect of" the goods imported by the appellant. Counsel also noted that this was the only aspect of the athlete's compensation against which the respondent had assessed duty.

Turning to the Royalty, counsel for the appellant submitted that the appellant does not dispute that the Royalty paid to NIKE Ireland is a royalty or licence fee within the meaning of subparagraph 48(5)(*a*)(iv) of the Act. However, they submitted that the Royalty should not be added to the transaction value of the goods in issue because it is not paid either "in respect of" or as a "condition of the sale" of the goods.

Counsel for the appellant submitted that, for a royalty or licence fee to be considered "in respect of" imported goods, there must be a direct connection or relationship between the royalty and the imported goods. They noted that, in the Tribunal's decision in *Polygram Inc.* v. *The Deputy Minister of National Revenue for Customs and Excise*,[7] it stated that general payments, unaffected by the specific sound recording imported, would not be in respect of the imported goods. They submitted that the Royalty is a general payment calculated on the appellant's sales of licensed goods, without regard to where the goods are actually manufactured or the value of the goods at the time of importation. The Royalty is also not a payment in respect of the goods because the rate of the payment does not vary according to the specific goods sold or to cost of production. Rather, the Royalty should be considered a general payment more closely linked to the appellant's selling efforts, in that the actual amount of the Royalty varies according to the particular customer that buys the goods from the appellant, due to factors such as volume discounts. As the Royalty is paid in respect of trademark and distribution rights relating to the resale of the goods in Canada, it cannot be said to be paid in respect of the sale for export to Canada. In addition, the evidence shows that the Royalty is payable on all goods sold by the appellant, even though sourced in Canada, as reflected in the shoes purchased from Bata and apparel and posters purchased from Canadian manufacturers.

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7. Appeal Nos. AP-89-151 and AP-89-165, May 7, 1992.

Counsel for the appellant submitted that the payment of the Royalty is not a "condition of the sale" of the goods from any particular Asian manufacturer to the appellant for a number of reasons. They stated that the appellant's situation represents the traditional tripartite case where the appellant pays a royalty to a licence holder pursuant to a licence agreement that provides the appellant with the rights to sell goods under certain trademarks in Canada. The manufacturer of the goods is not related to either the appellant or the licence holder. According to the advisory opinions of the Technical Committee on Customs Valuation[8] (the advisory opinions), these circumstances are such that the Royalty should not be considered dutiable.

Counsel for the appellant submitted that the question of whether a purchaser was able to purchase and import the goods without payment of a royalty should be posed from the perspective of the vendor of the goods, in this case, the Asian manufacturers. This, in turn, requires consideration of the terms of the contract between these manufacturers and the appellant. They submitted that paragraph 9.6 of the 1992 Agreement expressly states that payment of the Royalty is not a condition of the sale of the goods for export to Canada. Put differently, payment of the Royalty is independent of the sourcing of the goods, as the appellant is free to source the goods from any supplier it chooses, providing the quality requirements for the goods are met. The supply agreement between the appellant and NIKE, Inc. also does not contain any requirement that the Royalty be paid before the manufacturer sells the goods to the appellant. Under this agreement, NIKE, Inc. acts as a buying agent on behalf of all the companies in the NIKE group. The appellant pays a fee for the services that it receives under this agreement.

Counsel for the appellant noted that a number of related cases heard by the Tribunal have focused on whether there are any implied conditions in an agreement between a manufacturer and a purchaser in the sale for export to Canada that would indicate that the sale was conditional on the payment of a royalty. In addition to *Polygram*, counsel referenced the Tribunal's decision in *Reebok Canada Inc., a division of Avrecan International Inc.* v. *The Deputy Minister of National Revenue for Customs & Excise*,[9] *Jana & Company* v. *The Deputy Minister of National Revenue*,[10] and *Mattel Canada Inc.* v. *The Deputy Minister of National Revenue*.[11] In these cases, the Tribunal focused on whether the licensor exerted sufficient control over the sales for export through ownership, contract or otherwise to make the manufacturer's sales conditional on the payment of the royalty. Counsel reviewed a number of these factors in the context of these decisions. They noted that the Tribunal has considered, among other things, whether the purchaser was free to source goods from other manufacturers and could request design changes. They submitted that the evidence showed that this is the case here. They submitted that the evidence shows that neither NIKE Ireland nor NIKE, Inc. controlled the sales by the Asian manufacturers to the appellant to the extent that the appellant would not be able to purchase and import the goods without payment of the Royalty to NIKE Ireland.

Counsel for the appellant submitted that the appellant's situation could be distinguished from the circumstances in *Reebok* in a number of ways. First, the evidence of Reebok Canada confirmed that it was purchasing the imported goods effectively as a distributor, that is, the goods were actually being manufactured on behalf of Reebok US. Second, the evidence of Reebok Canada indicated that Reebok US exercised some control over the foreign factories involved, which was reflected in the nature of the

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8. Specifically referring to Advisory Opinions 4.8 and 4.13, *Royalties and Licence Fees under Article-8.1(c) of the Agreement*, *GATT Agreement and Texts of the Technical Committee on Customs Valuation*, Customs Co-operation Council, Brussels.
9. Appeal No. AP-92-224, September 1, 1993.
10. Appeal No. AP-94-150, September 3, 1996.
11. Appeal Nos. AP-95-126 and AP-95-255, January 15, 1997.

agreements between the factories and Reebok US. Here, NIKE, Inc. enters into the supply agreement for its own account in respect of its own requirements, but also as a buying agent for the NIKE group. Third, Reebok US, not Reebok Canada, owned the footwear designs and specifications, and Reebok US was the only entity which could legally make them available to a manufacturer. Finally, this difference with respect to designs and specifications is also reflected in the manner in which the value of the designs has been treated for duty purposes. In this case, the appellant pays a duty on applied product development charges as an assist. It was submitted that some portion of the licence fee paid by Reebok Canada was reasonably attributed to this matter and would have been properly included in the duty base. In this regard, counsel submitted that, in contrast to the appellant's situation, neither Reebok Canada nor the importer in *Signature Plaza Sport Inc.* v. *Her Majesty the Queen*[12] had the independent right to product specifications needed to have goods produced for them, but for payment of their respective royalties. Counsel concluded that there is not "sufficient nexus" between the licence payments made by the appellant and the sale for export from the Asian manufacturers to conclude that payment of the Royalty was made as a condition of these sales.

With respect to the Federal Court's decision in *Reebok*, counsel for the appellant noted that their arguments regarding the issue of whether Royalty was paid "in respect of" the imported goods are essentially the same arguments that were rejected by both the Tribunal and the Federal Court. Counsel acknowledged that the effect of the Federal Court's decision is that the Royalty is to be regarded as having been paid "in respect of" the licensed goods in this case. Turning to the Athlete Royalty and whether it is "in respect of" the licensed goods, counsel submitted that the Federal Court's decision confirmed the approach that they advocated, i.e. the question is not simply whether the payment is calculated by reference to net sales or gross sales of the licensed goods, but, more fundamentally, what is the benefit derived by the payer for the payment. The evidence in this case is that the Athlete Royalty is paid by the appellant for the benefit of the advertising services provided by the athletes. Furthermore, this issue relates to whether these payments can even be considered "royalties" within the meaning of subparagraph 48(5)(*a*)(iv) of the Act. Counsel submitted that the Federal Court's consideration of the Tribunal's approach in *Reebok* supports the conclusion that the Athlete Royalty is not a royalty within the meaning of the subparagraph.

Turning to the issue of "condition of the sale," counsel for the appellant submitted that the Federal Court's decision confirmed the Tribunal's general approach regarding the "condition of the sale" requirement set out in *Reebok* and applied in subsequent cases. They stated that, in each case, the factual question to be answered is whether the vendor of the goods, expressly or implicitly, requires the licensee to pay the royalty to the licensor as a pre-requisite to purchasing the goods, such that non-payment would result in the licensee being unable to purchase the goods. Counsel reiterated their arguments as to why the Royalty was not an express condition of sale. In arguing that it was also not an implied condition of sale, counsel once again made submissions of how the commercial and legal relationships among the relevant parties in the two cases can be distinguished.

Counsel for the respondent's argument first dealt with certain general propositions about the provisions of the Act. He submitted that the Tribunal needs to be particularly conscious of the definition of the phrase "price paid or payable." This definition is a very broad one, which, he submitted, includes all payments that are made or to be made, directly or indirectly, in respect of the goods, to or for the benefit of the vendor. Moreover, it is clearly broader than the price agreed upon by the buyer and seller, as suggested by the appellant. Counsel submitted that the appellant not only equated "price paid or payable" but also "transaction value" with the price agreed upon by the buyer and seller.

12. 169 N.R. 321, Federal Court of Appeal, File No. A-453-90, February 18, 1994.

Counsel for the respondent suggested that, based on the broad wording of the introduction to subsection 48(5) of the Act, the only way that the adjustments in subparagraph 48(5)(*a*)(iv) can be understood is as including payments that do not benefit the vendor. Furthermore, the meaning of "transaction value," when considered in the context of this broad reading, suggests that the transaction value is intended to capture the actual value of the goods at the time of importation. This would include not only the price that might include specific payments to the vendor but also any kinds of payments that can be quantified so as to capture the actual value of the goods. The importance of this view in this case is clear, as the evidence shows that goods bearing a well-known trademark such as NIKE are going to have a greater value than the same goods without the trademark.

Counsel for the respondent suggested that the Tribunal keep these submissions in mind, as he turned to consider the actual provisions of subsection 48(5) of the Act.

Counsel for the respondent submitted that, based on the decision of the Supreme Court of Canada in *Gene A. Nowegijick* v. *Her Majesty the Queen*,[13] the phrase "in respect of" should be given the widest possible scope. In order to suggest that a payment is not "in respect of" goods, he submitted, one would almost have to show that there is absolutely no relationship between them. Counsel suggested that the wording of paragraph 9.1 of the 1992 Agreement makes it impossible to argue that the Royalty and the Athlete Royalty were not "in respect of" the goods imported by the appellant. With respect to the Athlete Royalty, counsel stated that the respondent had not dealt with it separately in its submissions because it is essentially part of the Royalty payments and should be dealt with on the same footing.

With respect to whether the Royalty payment was "a condition of the sale" of the goods for export, counsel for the respondent submitted that the appellant's position was, in effect, that, as the appellant is not required to pay a fee pursuant to the terms of the purchase itself, then it is not a condition of the sale. Counsel referred the Tribunal to the following passage in *Reebok*, which he submitted, states the opposite:

> The fact that the phrase "as a condition of the sale" in subparagraph 48(5)(*a*)(iv) of the Act is preceded by the words "directly or indirectly" suggests that, although a fee may not be required pursuant to the terms of the purchase itself, it may still be considered to be a condition of the sale, as long as there is some connection between [the fee] and the goods purchased.[14]

He submitted that the question that the Tribunal must ask itself in this regard is whether the importer could have, or would have, purchased and imported the goods without having in place the licence agreement. If not, then the fee is a condition of the sale of the goods for export.

Counsel for the respondent submitted that, based on the evidence in this case, the Tribunal should answer this question in the negative. This submission was based on a number of factors, of which the relationship between the various companies in the NIKE group and the manner in which the goods are ordered and shipped are the most important. He referred to certain recitals in the Inter-Company Cost Sharing Agreement in support of the proposition that the appellant carries on NIKE's business in Canada, NIKE being either NIKE, Inc. or NIKE International. He submitted that the evidence shows that entering into the licence agreement is clearly contemplated by all the parties involved and that this is an absolute pre-requisite to the appellant being able to do business. Counsel submitted that the manner in which the goods are ordered and shipped shows that, as in *Reebok*, NIKE, Inc. controlled the actual manufacture of the goods by the factories and that the appellant would not have received the goods without having the licence

13. [1983] 1 S.C.R. 29.
14. *Supra* note 9 at 5-6.

agreement. As a result, the payment of the Royalty is clearly a condition of sale of the goods for export. With respect to the arrangements between the appellant and Bata, counsel suggested that this was a very exceptional circumstance which occurred before the audit period in question.

With respect to the Federal Court's decision in *Reebok*, counsel for the respondent submitted that the factual circumstances of this case are virtually identical to those considered to be relevant by the Federal Court. Concerning the issue of whether the Royalty was "in respect of" the licensed goods, counsel noted the appellant's concession regarding this matter. Concerning the Athlete Royalty, counsel submitted that the Tribunal has previously held that, where the amount of a royalty varies with the value of the goods in question, it is paid in respect of those goods. Nothing in the *Reebok* decision affects this test and thus, on the facts of this case, the Athlete Royalty is paid in respect of the licensed goods.

Turning to the issue of "condition of the sale," counsel for the respondent submitted that the Federal Court, in *Reebok*, recognized that the failure to pay royalties would give rise to a remedy, on the licensor's part, and to the possibility of loss of any right to market the trademarked goods, on the licensee's part. In these appeals, failure to pay royalties may result in termination of the 1992 Agreement and, in such circumstances, the appellant would no longer have the right to use any of the NIKE trademarks in Canada. Furthermore, counsel argued that the points raised by the appellant to distinguish this case from *Reebok* are not relevant, based on the facts considered relevant by the Federal Court. Accordingly, the Royalty is an amount that must be paid as a condition of the sale of the goods for export to Canada and is to be added to the price paid or payable to arrive at the value for duty of the goods in issue. Counsel submitted that the evidence relating to the Athlete Royalty shows a connection with the goods in a similar manner as endorsed by the Federal Court in *Reebok*, in that failure to make the payments will make it impossible for the appellant to sell NIKE goods in the future. Therefore, the Athlete Royalty should also be added to the price paid or payable to arrive at the value for duty of the goods in issue.

In reply, counsel for the appellant submitted that the respondent provided no authorities in support of what counsel called a very over-inclusive and outdated approach to the provisions of the Act being considered. This is to be contrasted with the submissions of the appellant based on the *Agreement on Implementation of Article VII of the General Agreement on Tariffs and Trade*,[15] commonly referred to as the Code, and the Act which, he submitted, suggest that, as a general rule, intangibles are not supposed to be included in the value for duty except in very specific situations. With respect to the additional value to a product that may come from the use of a particular trademark, counsel submitted that such value accrues to the product in the country of importation or sale and that it is inappropriate to add to the value for duty of a product value that is realized after importation. With respect to the Athlete Royalty, counsel asked the Tribunal to consider the relationship between the services provided by the athletes and the payments made in respect of the goods that are sold in Canada. Counsel suggested that they are not related subjects. Therefore, the payment does not satisfy the "in respect of" criterion. Counsel did not dispute that entering into a licence agreement was a prerequisite for the appellant to do business. However, counsel submitted, as the advisory opinions show, this does not render the sourcing of the goods a condition of payment of a royalty. If it did, there would never have been any case before the Tribunal to decide.

The Tribunal is of the view that the Athlete Royalty is not a royalty or licence fee described in subparagraph 48(5)(*a*)(iv) of the Act and, therefore, that it should not be added to the price paid or payable for the imported goods bearing the NIKE trademark in determining the value for duty of these goods. The

15. Geneva, March 1980, GATT BISD, 26th Supp. at 116.

Tribunal agrees with the appellant that these payments are not in respect of the goods, but rather are in respect of services provided by the athletes that are not sufficiently related to the importation of the goods to come within the meaning of the provision in question.

Turning to the Royalty, the Tribunal first notes the appellant's concession in its submissions in response to the Federal Court's decision in *Reebok* as it relates to the issue of whether the Royalty payments may be said to be "in respect of" the goods in issue. The Tribunal agrees with the parties that, in the circumstances of this case, these payments are royalty payments and are "in respect of" the goods in issue. However, the issue of whether the payments are a condition of the sale for export to Canada is a more complicated matter.

The Tribunal notes that, while it appears that the Federal Court's decision affirms the Tribunal's "some connection" test, in the Tribunal's view, the Federal Court goes further than the Tribunal did in *Reebok* in suggesting that it is significant that the royalties were 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] The Tribunal also notes that the Federal Court stated that, in its view, the Tribunal's decision in *Reebok* was consistent with evolving jurisprudence in regard to this issue. The Federal Court then made reference to the Tribunal's decision in *Polygram* and the Federal Court of Appeal's decision in *Signature Plaza*. The Tribunal wishes to comment on these decisions and decisions that it has made subsequent to *Polygram* and *Reebok*, such as *Jana* and *Mattel.*

In these cases and, in particular, as the Federal Court of Appeal emphasized in *Signature Plaza*, the issue of who is the vendor of the goods is critical to evaluating whether a royalty can be said to be a condition of sale for export. The Tribunal notes that, in these appeals, the parties agree that the vendor is the Asian manufacturing companies and not NIKE, Inc. This makes these appeals different from *Reebok* and *Signature Plaza*. Furthermore, the Tribunal is not persuaded, based on the evidence before it, that the manufacturers in these appeals would not sell to the appellant without the Royalty having been paid to NIKE Ireland. There is no evidence of any requirement that the appellant establish this to the manufacturers' satisfaction before the sale for export is complete. Having said this, the Tribunal acknowledges that it is unlikely that the sale would have occurred without a licence agreement being in place.

The Tribunal has indicated in previous decisions that it is of the view that this fact is not enough in itself to make a royalty payment a condition of sale between the appellant and the manufacturers. Otherwise, there would almost never be a case when such a payment was not included in the value for duty under subparagraph 48(5)(*a*)(iv) of the Act. In the Tribunal's view, this is not intended by the provision. As indicated in the advisory opinions, and as discussed by the Tribunal in *Jana*, 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.[17]

The Tribunal is also persuaded that other evidence relating to the issue of NIKE, Inc.'s "control" over the manufacturing process in these appeals indicates less "control" than that found in *Reebok* or *Signature Plaza*. The appellant had paid separately for development and designs assistance under the RDCAA. Furthermore, the appellant had and used its independent ability to obtain product on its own to a

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16. *Supra* note 3 at 9.
17. *Supra* note 8 and note 10 at 9-10.

significant degree. This is reflected in the fact that, during the audit period, the appellant sourced 20 percent of its goods directly from domestic sources.

However, as noted above, the Federal Court did not specifically focus on such distinctions. Rather, the Federal Court indicated that, as the royalties were 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. These two circumstances also apply in these appeals. Therefore , in light of the decision of the Federal Court in *Reebok*, the Tribunal finds that the Royalty must be considered a condition of the sale for export and, therefore, included in the value for duty of the goods in issue.

Accordingly, the appeals are allowed with respect to the Athlete Royalty and are dismissed with respect to the Royalty.

Arthur B. Trudeau
Arthur B. Trudeau
Presiding Member

Dr. Patricia M. Close
Dr. Patricia M. Close
Member

Lyle M. Russell
Lyle M. Russell
Member