Business and Legal Strategies for Combating Grey-Market Imports

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Business and Legal Strategies for Combating Grey-Market Imports

U.S.-based manufacturers and exclusive licensees of foreign products often find themselves in the unlikely position of competing against their own goods imported from abroad. These competing products are parallel imports or grey-market goods.

Grey-market goods are products sold in the United States that were lawfully produced, but which the manufacturer or authorized reseller did not intend for sale in the United States. Three distinct scenarios are the most common sources of parallel imports. First, a producer may manufacturer goods in the United States for export sale only and find that the merchandise has been diverted back to the U.S. market either before or after exportation. Second, goods made abroad by a foreign licensee may be imported into the United States without the authorization of the U.S. licensor. Finally, goods made abroad either by the manufacturer or a licensee may be imported into the U.S. market to compete with goods offered by the authorized U.S. licensee.

This article reviews the legal framework surrounding the parallel importation phenomenon and seeks strategies by which U.S. producers and licensees may protect their interests against unauthorized importations. All of the merchandise discussed below is genuine in that it was manufactured by a company authorized to do so. This article does not address the importation of counterfeit merchandise or products that infringe a U.S. patent.¹

¹ The importation of goods bearing counterfeit trademarks is prohibited under 19 U.S.C. § 1526(e) (1994). The U.S. Customs Service (Customs) is authorized to seize such merchandise when it is presented for entry. Id.; 19 C.F.R. § 133.23a (1997). Similarly, importing merchandise
I. Who Benefits

Parallel importations occur because of price differences in the global marketplace. A publisher of computer software may, for example, have only a small market share in Mexico. As a business strategy, that publisher may legitimately decide to introduce a new product into the Mexican market at a substantial discount compared to the sales price for the same product in the United States. If the discount is large enough, U.S. parties are able to purchase the software in Mexico and import it to the United States for resale at a discount over the same product in authorized channels.

In other cases, a manufacturer may limit its retail distribution to upscale markets. This strategy is common practice in the cosmetics trade, in which some products are only sold through salons or selected stores. Discount retailers who would like to sell the same product often find it on sale abroad at deeply discounted prices. That fact gives the discounter an opportunity to import the merchandise and enter the market from which the producer tried to exclude it.

Proponents of parallel imports argue that the practice gives discount retailers and consumers an alternative source of merchandise and encourages price competition. Without parallel sourcing, the argument goes, manufacturers are able to set prices in the United States higher than those in other countries. Thus, parallel importers are seen as consumer-friendly enterprises fighting price discrimination by manufacturers of elitist products.

II. Who Is Hurt

Opponents of parallel imports argue that the practice interferes with their contracts with exclusive licensees and that the unauthorized resellers are free-riding on the authorized sellers' marketing expense and savvy. Thus, authorized licensees do not get the full benefit of their license fees and no authorized retailer gets the full benefit of its advertising and marketing expenses.

In addition, authorized resellers or licensees may be subject to contractual control by the licensor or manufacturer. The licensor may, for example, require authorized outlets to have trained sales personnel or service departments or to maintain an inventory of service parts. Parallel importers lack privity with the licensor or manufacturer and are under no obligation to provide this level of customer service. Consumers, unaware that they are purchasing from an unauthorized seller, may develop a negative opinion of the product when they receive that infringes a U.S. patent is an unfair trade practice, see 19 U.S.C. § 1337 (1994), and the International Trade Commission (ITC) is authorized to issue orders excluding such merchandise from the United States.

inferior service. Thus, grey-market products may undercut the goodwill of authorized resellers.

This may occur when consumers seek warranty service on a grey-market product. If the factory refuses to service the good, this refusal will alienate the consumer. However, the factory has no obligation to service the good and will incur an unplanned expense if it provides the service. Thus, unwary consumers of grey-market goods usually get products without a factory warranty and do not receive the full benefit of their bargains. Parallel importers, however, argue that the savings in price make up for these deficiencies and that service is usually available when needed, but at an additional cost to the consumer.

III. Trademark

The obvious starting point for a U.S. manufacturer seeking to exclude grey-market merchandise is trademark law. A party with U.S. trademark rights expects to be able to prevent another party from importing or selling goods, even genuine goods, under the same trademark without authorization. After all, the trademark is misidentifying the source of the products.Trademark law, however, does not provide that clear of an answer.

The leading case on the application of trademark law to parallel imports is the Supreme Court decision in A. Bourjois & Company, Inc. v. Katzel. The facts of that case set out one of the principal examples of how the grey-market operates. Plaintiff was the assignee of a trademark in the United States from a French cosmetics company. The French company continued to operate in France, where it produced identical goods, including those it sold to Plaintiff. Katzel, taking advantage of a favorable exchange rate, imported genuine merchandise from France and began to sell it under the plaintiff's trademark in the United States.

The Supreme Court based its conclusion that the sale of the grey-market merchandise infringed the U.S. trademark on the assignment from the French company. The court stated that because the French firm could no longer sell its wares in the United States, it could not authorize another to do so. From that premise, the Court concluded that "[o]wnership of the goods does not carry the right to sell them with a specific mark. It does not necessarily carry the right to sell them at all in a given place." Katzel argued that the use of the trademark of the French manufacturer was factually correct and did not lead to consumer confusion. In response, the court held that:

4. Id. at 691-92.
5. Id. at 692.
It is said that the trade-mark here is that of the French house and truly indicates the origin of the goods. But that is not accurate. It is the trade-mark of the plaintiff only in the United States and indicates in law, and, it is found, by public understanding, that the goods come from the plaintiff although not made by it. It was sold and could only be sold with the good will of the business that the plaintiff bought.  

From this pro-trademark holder decision, one would expect that trademark law prohibits the sale and importation for sale of genuine goods bearing trademarks owned by a U.S. entity. The Supreme Court, however, soon found an exception from *Katzel*.

In *Prestonettes, Inc. v. Coty*, Prestonettes purchased genuine Coty face-powder, repackaged it with its own base, and sold it in containers identifying Coty as the manufacturer of the powder. The containers were otherwise distinguishable from genuine Coty products. The Supreme Court, via Justice Holmes, who also wrote *Katzel*, held that this exercise did not amount to actionable infringement:

> The plaintiff could not prevent or complain of [defendant's] stating the nature of the component parts and the source from which they were derived if it did not use the trade-mark in doing so. . . . If the compound was worse than the constituent, it might be a misfortune to the plaintiff, but the plaintiff would have no cause of action, as the defendant was exercising the rights of ownership and only telling the truth. . . . A trade-mark only gives the right to prohibit the use of it so far as to protect the owner's good will against the sale of another's product as his. United Drug Co. v. Theodore Rectanus Co., 248 U.S. 90, 97, 39 Sup. Ct. 48, 63 L. Ed. 141. There is nothing to the contrary in A. Bourjois & Co. v. Katznel, 260 U.S. 689, 43 S. Ct. 244, 67 L. Ed. 464, 26 A.L.R. 567. . . . When the mark is used in a way that does not deceive the public we see no such sanctity in the word as to prevent its being used to tell the truth. It is not taboo. Canal Co. v. Clark, 13 Wall. 311, 327, 20 L. Ed. 581.  

Thus, the rule prior to the Lanham Act appears to have been that a parallel importer could rely on the trademark to identify the source of the product, but could not apply the mark in a way that would lead a consumer to believe the U.S. trademark holder was the seller.

This interpretation of the law represents a change in the philosophy of trademarks. Prior to *Katzel*, trademarks were considered to have universal scope. Consequently, a party purchasing a trademarked good abroad was free to import that merchandise and sell it in the United States without fear of infringing a U.S.-held trademark. Eventually, however, the courts recognized that trademarks relate to the use in business of a mark and are, therefore, inherently territorial. *Katzel* is an example of this change in approach. Moreover, trademarks

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6. Id.
8. Id. at 361.
enforceable in federal courts are derived from statutory law that has no application extraterritorially. Thus, no basis exists on which to presume that a U.S.-origin trademark carries with it the same goodwill when the product is sold by a third party in Mexico, Europe, or elsewhere.\textsuperscript{10}

 Currently, section 42\textsuperscript{11} of the Lanham Act addresses the importation of merchandise bearing trademarks that "copy or simulate" a U.S.-owned mark.\textsuperscript{12} The Lanham Act, however, does not specify whether a foreign trademark legitimately applied to genuine merchandise "copies or simulates" the identical trademark in use in the United States. As a result, the status of imported products bearing genuine trademarks was left to the courts. That issue was addressed in \textit{Lever Bros. Co. v. United States.}\textsuperscript{13}

 The issue in \textit{Lever Bros.} was whether the U.S. Customs Service (Customs) properly refused to prohibit the unauthorized importation of merchandise from the United Kingdom bearing a U.S. trademark legitimately applied abroad. The merchandise involved deodorant soap and dishwashing liquid manufactured by Lever's related party in the United Kingdom. A third party purchased a supply of the merchandise and imported it for sale in the United States. Lever sought the assistance of Customs to bar the importation pursuant to section 1124.\textsuperscript{14} Customs refused on the basis of a regulatory exception that is discussed below in the section relating to the Tariff Act.\textsuperscript{15}

 The first question before the D.C. Circuit in \textit{Lever Bros.} was whether section 42 barred the importation of such merchandise. The court noted a number of cases in which courts permitted importation of grey-market merchandise in the face of a challenge based on the Lanham Act. Many of these decisions permitted

\textsuperscript{10} See, \textit{e.g.}, Apollinaris Co. \textit{v.} Scherer, 27 F. 18 (C.C.S.D. N.Y. 1886); Fred Gretsch Mfg. Co. \textit{v.} Schoening, 238 F. 780 (2d Cir. 1916).


\textsuperscript{12} No article of imported merchandise which shall copy or simulate the name of the [sic] any domestic manufacture, or manufacturer, or trader, . . . or which shall copy or simulate a trademark registered in accordance with the provisions of this chapter or shall bear a name or mark calculated to induce the public to believe that the article is manufactured in the United States, or that is manufactured in any foreign country or locality other than the country or locality in which it is in fact manufactured, shall be admitted to entry at any customhouse of the United States. . .

\textit{Id.}

\textsuperscript{13} Lever Bros. Co. \textit{v.} United States, 877 F.2d 101 (D.C. Cir. 1989). According to the Court of Appeals for the District of Columbia Circuit:

[t]he plain language and general sweep of the Lanham Act undeniably bespeak an intention to protect domestic trademark holders from foreign competitors who seek a free ride on the goodwill of domestic trademarks. But neither § 42 nor the Lanham Act as a whole draws an explicit line between goods that "copy or simulate" a trademark and ones that do not—known as "genuine" goods.

\textit{Id.} at 105.

\textsuperscript{14} \textit{Id.} at 104.

\textsuperscript{15} See, \textit{infra}, text accompanying notes 101-14.
the entry of the merchandise on the grounds that the merchandise was genuine and, thus, no confusion or consumer deception was involved. In each of these cases, however, the merchandise was identical to the goods offered for sale in the United States under the trademark.

Lever, however, presented a different scenario in that the merchandise as sold in the United Kingdom was modified to the tastes and preferences of British consumers and British conditions. U.S. purchasers of the grey-market soap, the court reasoned, will not receive the product they expected and may gain a negative opinion of the U.S. trademark holder. In the end, the presence of the grey-market products could result in a loss of goodwill for the trademark holder in the United States. The court noted several prior cases in which courts found differences in the imported product to justify excluding merchandise from the U.S. market on the basis of the Lanham Act. Based on these cases, the court in Lever Bros. concluded that material physical differences in a grey-market product mean that the trademark applied to the grey-market product “copies or simulates” the U.S. trademark. As a result, it ordered the merchandise excluded from the U.S. market under section 42.

The rule to be deduced from Lever Bros. and the cases cited therein is that a U.S. trademark holder may rely on section 42 of the Lanham Act to exclude parallel importations when the goods offered for sale abroad are materially different from those offered in the United States. When material differences exist,

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17. Lever Bros. Co., 877 F.2d at 103. The soaps were formulated to work with the harder water common in the United Kingdom. In addition, the deodorant soap contained less perfume than the U.S. product and was formulated to produce less lather because of the British practice of taking baths rather than showering.

18. See, e.g., Original Appalachian Artworks, Inc. v. Granada Elec., Inc., 816 F.2d 68 (2d Cir. 1987) (Spanish-language adoption papers in Cabbage-Patch Kids dolls and lack of system to send birthday cards to dolls violated section 32(1)(a) of Lanham Act, 15 U.S.C. § 1114(1)(a) (1994), which prohibits the use of a trademark when it “is likely to cause confusion, or to cause mistake, or to deceive.”). See also Dial Corp. v. Encina Corp., 643 F. Supp. 951 (S.D. Fla. 1986) (goods produced abroad under a geographically limited license and physically distinct from those of the U.S. trademark holder barred under section 32).


20. For a similar result, see Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F.2d 633 (1st Cir. 1992), in which an unauthorized party imported chocolates manufactured in Venezuela under a license from the Italian trademark holder, but not intended for sale in the United States. The plaintiff was the exclusive licensee in Puerto Rico for the distribution of the Italian-made product. In analyzing a claim under section 32 of the Lanham Act, the court of appeals held that the unauthorized importation and sale of materially different merchandise violates Lanham Act section 32 because a difference in products bearing the same name confuses consumers and impinges on the local trademark holder’s goodwill. Id. at 638. Section 32 of the Lanham Act, 15 U.S.C. § 1114 (1994), provides the general proscription against trademark infringement. Section 32 prohibits the use in commerce of any “reproduction, counterfeit, copy, or colorable imitation of a registered mark . . . [when] such use is likely to cause confusion, or to cause mistake, or to deceive.” 15 U.S.C. § 114(1)(a).
the product reaching consumers through unauthorized channels is not what the U.S. trademark is intended to represent. This misrepresentation will naturally lead to consumer confusion, if not deception.

What constitutes a material difference is, therefore, a fundamental question. In *Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.*, the court faced a determination of whether unauthorized chocolates were materially different from the authorized product. To that end, the court found several factors material, including quality control procedures, product composition, product configuration, packaging, and price. In analyzing these differences, the court stated:

We conclude that the existence of any difference between the registrant’s product and the allegedly infringing gray good that consumers would likely consider to be relevant when purchasing a product creates a presumption of consumer confusion sufficient to support a Lanham Act Trade-Mark claim. Any higher threshold would endanger a manufacturer’s investment in product goodwill and unduly subject consumers to potential confusion by severing the tie between a manufacturer’s protected mark and its associated bundle of traits.

Similarly, in *Martin’s Herend Imports v. Diamond & Gem Trading* the court found differences in the fact that an unauthorized importer offered for sale in the United States figurines the manufacturer chose not to offer. The grey-marketer also imported figurines that were sold in the United States, but with a different color pattern. The court found these differences to be material.

When the parallel imports consist of identical merchandise, the question is more complicated. Manufacturers and licensees cannot argue that the consumer is being deceived or misled as to the source of the merchandise. The Ninth Circuit dealt with this question in *NEC Electronics v. CAL Circuit Abco*. In that case, NEC-Japan assigned its U.S. trademark rights to its U.S. subsidiary. NEC-U.S. sold Japanese-made computer chips under the NEC trademark in the United States. Abco imported identical chips it purchased abroad and sold them in the United States in competition with NEC. NEC-U.S. claimed the sales (although

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Lever Bros. Co. also relied on sections 32 and 43(a) cases to reach its conclusion. Section 43(a), 15 U.S.C. § 1125 (1994), prohibits the use of a word, symbol, or device to create a false designation of origin, false or misleading description of fact, or false or misleading representation of fact that is likely to cause confusion, mistake, or deception.


22. *Id.*

23. *Id.* at 641.


25. The Martin’s Herend Imports court reasoned that the selection of which figurines to sell in a given market is important in maintaining the caché of the product line. The fact that some goods are deemed inappropriate for the U.S. market implies they are subjectively different in a way that is meaningful to the consumer. Thus, these unauthorized imports were sufficiently different from the authorized product to fall within the rule of Nestle. *Id.* at 1302.

26. *Id.*

27. *NEC Elecs. v. CAL Circuit Abco*, 810 F.2d 1506 (9th Cir. 1986).
not the importations) constituted infringement under sections 32\(^\text{28}\) and 43(a)\(^\text{29}\) of the Lanham Act.\(^\text{30}\)

The Ninth Circuit began its analysis with a statement that trademark law generally does not address the resale of genuine merchandise. The court relied on \textit{Coty} and other cases for this premise\(^\text{31}\) and had to somehow distinguish the contrary holding in \textit{Katzel}. The court accomplished this distinction by noting that in \textit{Katzel}, the U.S. trademark owner was completely independent of the French trademark owner and, therefore, had no control over the nature of the product being produced abroad. The French company was free to begin producing an inferior product or even a completely distinct product. In that case, parallel imports bearing the U.S. mark would likely confuse consumers.\(^\text{32}\)

NEC-U.S., to the contrary, was a wholly owned subsidiary of NEC-Japan. Under these circumstances, the court found that NEC-U.S. was not deprived of any right to control the merchandise sold in the United States. The basis for this decision was that NEC-Japan controlled NEC-U.S. and could dictate the nature of merchandise sold in the United States. Further, the court noted that the merchandise sold under the NEC trademark was at all times produced under the direction and control of NEC-Japan. Thus, the Ninth Circuit felt \textit{Katzel} did not

\(^{28}\) See Section 32 of the Lanham Act which defines trademark infringement. This section provides that
(1) Any person who shall, without the consent of the registrant—
   (a) use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive; or
   (b) reproduce, counterfeit, copy, or colorably imitate a registered mark and apply such reproduction, counterfeit, copy, or colorable imitation to labels, signs, prints, packages, wrappers, receptacles or advertisements intended to be used in commerce upon or in connection with the sale, offering for sale, distribution, or advertising of goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive, shall be liable in a civil action by the registrant for the remedies hereinafter provided.

\(^{29}\) See Section 43(a) which provides:
Any person who shall affix, apply, or annex, or use in connection with any goods or services, or any container or containers for goods, a false designation of origin, or any false description or representation, including words or other symbols tending falsely to describe or represent the same, and shall cause such goods or services to enter into commerce, and any person who shall with knowledge of the falsity of such designation of origin or description or representation cause or procure the same to be transported or used in commerce or deliver the same to any carrier to be transported or used, shall be liable to a civil action by any person doing business in the locality falsely indicated as that of origin or in the region in which said locality is situated, or by any person who believes that he is or is likely to be damaged by the use of any such false description or representation.

\(^{30}\) \textit{NEC Elecs.}, 810 F.2d at 1508.
\(^{31}\) \textit{Id}. at 1509.
\(^{32}\) \textit{Id}. at 1509-10.
control and permitted the grey-market sales. The Second Circuit adopted a similar analysis in *Olympus Corp. v. United States.* The NEC court stated in its conclusion that:

[i]f NEC-Japan chooses to sell abroad at lower prices than those it could obtain for the identical product here, that is its business. In doing so, however, it cannot look to United States trademark law to insulate the American market or to vitiate the effects of international trade. This country's trademark law does not offer NEC-Japan a vehicle for establishing a worldwide discriminatory pricing scheme simply through the expedient of setting up an American subsidiary with nominal title to its mark.

Other courts, however, are less willing to merge a foreign corporation with its U.S. subsidiary or licensee. For example, in *Osawa & Company v. B & H Photo,* the court focused on the fact that the plaintiff, a U.S. corporation and the exclusive licensee of the trademark in question, was entitled to exercise its right to protect its trademark in the United States. *Osawa* involved the importation of grey-market Mamiya cameras from Japan. The defendants contended that their legal purchase of the genuine cameras in Japan precluded an action by plaintiff. The court, however, noted the extensive services and quality controls available through authorized resellers in the United States. In addition, the U.S. trademark holder engaged in significant advertising designed to enhance its reputation for quality and service and provided warranty service to its customers. As a result, the plaintiff incurred a number of expenses defendant was able to avoid. Taken together, these additional expenses, the resulting loss of revenue, and decreased goodwill led the court to find a danger of irreparable harm from the grey-market imports.

On the merits, the court's analysis focused on the territoriality of trademarks and the premise that trademarks symbolize the local goodwill of the trademark holder who should be protected against the use of the mark by others in domestic commerce. Plaintiff, having strived to develop substantial independent goodwill in the United States through its advertising and high-quality products and services,

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33. *Id.* at 1510.
34. *Olympus Corp.* v. United States, 792 F.2d 315 (2d Cir. 1986), *cert. denied*, 486 U.S. 1042 (1988). Although *Olympus* relied on the importation provisions of section 42 of the Lanham Act, the analysis was substantially the same.
35. *NEC Elecs.*, 810 F.2d at 1511.
37. For example, authorized resellers were required to maintain a stock of peripheral devices. In addition, the plaintiff conducted educational seminars for customers and required that resellers provide a high level of service to the customer. *Id.* at 1165-66.
38. *Id.* at 1166.
39. *Id.* at 1167. To the extent that defendants engaged in advertising and incurred other expenses, those expenses did not support the Mamiya trademark in the United States. *Id.* In addition, the plaintiff actually chose to provide warranty work to purchasers of grey-market cameras in order to preserve its goodwill with those customers. *Id.*
40. *Id.* at 1168-70. Because of the loss of sales, the plaintiff was forced to cut back on its workforce. This cutback led to an increase in the time for repairs. The plaintiff also decreased its advertising budget. Both factors contributed to a major decline in sales.
41. *Id.* at 1172.
was entitled to the protection of its trademark separate and apart from the same mark applied by the manufacturer in Japan.\textsuperscript{42} Thus, the court granted a preliminary injunction against the importation of identical grey-market merchandise solely to protect the separate goodwill of the domestic trademark holder. This decision came over defendant’s objections that the price disparity creating opportunities for grey-market entrepreneurs was entirely the result of price discrimination by the Japanese manufacturer. The Third Circuit reached a similar conclusion in \textit{Premier Dental Prods. Co. v. Darby Dental Supply Co.},\textsuperscript{43} in which it held that where a trademark is owned and registered in this country by an exclusive distributor who is independent of the foreign manufacturer and \textit{who has separate goodwill} in the product, the distributor is entitled under section 526 to prevent the importation even of genuine merchandise obtained from the same foreign manufacturer.\textsuperscript{44}

\section*{IV. Copyright}

A copyright owner has the exclusive right to distribute copies of the owner’s work.\textsuperscript{45} Thus, a third party may not, without the authorization of the copyright holder, sell, rent, transfer, or otherwise distribute copies of the work. Section 602 of the Copyright Act of 1976 identifies a specific form of the distribution right when it provides that an unauthorized importation is a violation of the distribution right of section 106 and is a copyright infringement under section 501.\textsuperscript{46} A number of exceptions to the importation right exist, including imports for personal use with passengers returning to the United States. Those exceptions, however, are not applicable to commercial operations such as grey-market importers.

Producers of goods facing grey-market competition have seized upon the importation right as a means of excluding their own goods from the U.S. market.\textsuperscript{47} These producers argue that the unauthorized importation is a violation of the distribution right and, therefore, an infringement. In the case of consumer products, the claim for copyright normally rests on art or text on product labels. The plain language of section 602 seems to support this argument.

\begin{flushright}
\textsuperscript{42} Id. at 1174. The fact that the U.S. trademark holder was related to the foreign trademark holder and manufacturer did not appear to concern the court. The court distinguished the domestic mark from the foreign mark and permitted the U.S. holder to protect the goodwill it developed in this country. \textit{Id.}
\textsuperscript{43} Premier Dental Prods. Co. v. Darby Dental Supply Co., 794 F.2d 850 (3d Cir. 1986).
\textsuperscript{44} Id. at 858 (emphasis added).
\textsuperscript{46} Importation into the United States, without the authority of the owner of copyright under this title, of copies or phonorecords of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies or phonorecords under section 106, actionable under section 501.
\end{flushright}
The law, however, provides a number of exceptions to the distribution right embodied in section 106. Relevant to this article is the first sale doctrine of section 109. Under the first sale doctrine, the legitimate owner of a copy of a work may freely distribute that copy by sale, lease, loan, or other transfer. Importers of grey-market merchandise base their defense to claims of copyright infringement of the importation right on the theory that merchandise legitimately purchased abroad is subject to the first sale doctrine and, as a result, they may transfer that merchandise as they see fit, including the importation of the merchandise for resale.

The leading case on the interplay between the first sale doctrine and the importation right is Columbia Broadcasting Sys. v. Scorpio Music Dist., Inc. In Scorpio Music, CBS held the U.S. copyrights on a number of sound recordings. A Japanese party related to CBS entered into an agreement permitting a Philippines-based company to manufacture and to sell copies of those works exclusively in the Philippines. Scorpio Music, in the meantime, ordered sound recordings from a Nevada-based company that, in turn, purchased them from a Philippines company, which purchased the sound recordings from the authorized manufacturer in that country. CBS sued Scorpio for importing the phonorecords without its consent. Scorpio interposed a motion for summary judgment based, in part, on there having been a valid first sale in the Philippines.

Looking to the language of section 109(a), the court focused on the phrase "lawfully made under this title" to limit the scope of the first sale doctrine to goods legally manufactured and sold within the United States, rather than imported goods. The court based this conclusion on the principal that U.S. law does not generally apply outside the borders of the country. The court also found that if the first sale doctrine trumped the importation right, section 602 is virtually without meaning, as any third party seeking to sell copyrighted materials in the United States could circumvent the copyright holder by purchasing the goods abroad. Thus, the court denied summary judgment and permitted the case to go to trial.

49. Section 109 provides:
   Notwithstanding the provisions of section 106(3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.
17 U.S.C. § 109 (1994). This rule, however, is subject to several exceptions including limitations that prevent the owners of sound recordings and computer software from renting out the copies. See id. § 109(b) (1994).
51. Id. at 48.
52. Scorpio also argued that it was not the importer of the records and, therefore, not a proper defendant. The court, however, rejected this argument because the bill of lading for the merchandise showed Scorpio as a consignee, and consignees may be treated as importers. Further, the court found that even if Scorpio was not the importer, its role in ordering the merchandise made it a contributory copyright infringer. Thus, Scorpio was a proper defendant. Id. at 48-49.
53. Id. at 49.
54. Id.
A different result was reached in *Sebastian Int'l, Inc. v. Consumer Contacts (Pty) Ltd.*, in which the imported merchandise was hair care products. Sebastian manufactured and sold its products in the United States. All of Sebastian's U.S. sales were through professional salons rather than traditional retail stores. Sebastian entered into an agreement to permit the defendant to distribute its products in South Africa, but not elsewhere. Upon receipt in South Africa, the defendant immediately shipped the goods back to an unrelated buyer in the United States. Sebastian sued, claiming the unauthorized importation was a copyright infringement. The district court agreed and issued a preliminary injunction preventing further distribution in the United States by the defendant.

The court of appeals started its analysis with a review of first sale cases holding that once the copyright holder decides to sell a copy of the work, the copyright holder has no right to control future transfers. These cases, according to the court, are based on the principal that once the copyright holder makes a voluntary sale of a copy of the work, the copyright holder receives its reward for the use of that work. The court then went on to find that the importation right of section 602 is not separate from that distribution right of section 106. As a result, the Third Circuit held that the first sale doctrine is applicable to importations as well as domestic sales.

More recently, in *Parfums Givenchy, Inc. v. Drug Emporium, Inc.*, the Ninth Circuit reached a contrary result. The facts in this case were similar to *Sebastian*. The merchandise was perfume produced in France and sold in upscale stores in a box subject to a U.S. copyright. Unauthorized parties purchased quantities of the merchandise abroad and imported it for sale in discount stores. Drug Emporium argued that the first sale doctrine of section 109 supersedes the importation right of section 602. Thus, Givenchy had no right to prevent the importation of lawfully purchased merchandise. The court disagreed.

According to the Ninth Circuit, Congress intended section 602(a) to provide a means of prohibiting the importation of lawfully made copies of copyrighted works purchased abroad. As a result, a U.S. copyright holder is able to gain the full value of each copy sold in this country. The court noted it had addressed this same issue previously and rejected similar arguments. The basis for this ruling was the "lawfully made under this title" language in section 109(a). The court agreed with *Scorpio Music* that this language means the first sale doctrine

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56. *Id.* at 1094-95. The district court opinion is reported at 664 F. Supp. 909 (D.N.J. 1987).
60. *Id.* at 479.
61. *Id.* at 481.
applies only to sales made within the United States. A contrary reading, according to the court, renders section 602 meaningless.

The Ninth Circuit addressed this question again in *L'anza Research Int'l, Inc. v. Quality King Distributors, Inc.*[^Lanza1]|[^Lanza2] L'anza is similar in most ways to *Sebastian*: the merchandise involved is hair care products, the plaintiff tried to limit its U.S. distribution to salons and colleges, and the producer made sales to third parties abroad. *L'anza* contained the additional fact that the foreign sales were at a substantial discount when compared to U.S. sales.[^Lanza3] *L'anza* is also different from *Givenchy* and *BMG Music* because merchandise was manufactured in the United States, presumably subject to sale here, exported, and then imported without the authorization of the copyright holder. According to the district court, this fact could make the first sale doctrine applicable to the merchandise. The court found, however, that the sale did not take place in the United States and, therefore, the first sale doctrine did not apply.[^Lanza4]

On appeal, the *L'anza* court specifically refused to base its decision on the phrase ""lawfully made under this title" in section 109(a).[^Lanza5] Rather, the court relied entirely on the principle that reading section 109(a) as superseding section 602(a) renders the latter provision meaningless and that such a reading cannot be correct.[^Lanza6] The court went on to thoroughly discuss the congressional intent behind the importation right.

According to the court, Congress enacted section 602(a) to protect U.S. copyright holders from legitimate as well as piratical copies entering the United States. Congress took this step based on the urging of domestic publishing and recording industries. These industries complained that the importation of legitimate copies was undermining their ability to control the distribution of their products within the United States through authorized channels of trade. Thus, copyright holders were unable to reap the full value of their copies in the United States.[^Lanza7]

An example of this problem occurs when a videotape distributor sells copies of movies in the United States at $20 each. To be competitive in England, the distributor sells the same tapes there for $13. If a third party purchases tapes in England and sells them in the United States at $18, the U.S. copyright holder

[^Lanza1]: L'anza Research Int'l Inc. v. Quality King Distrbs., Inc., 98 F.3d 1109 (9th Cir. 1996), cert. granted, 117 S. Ct. 2406, 1997 U.S. LEXIS 3536.

[^Lanza2]: Id. at 1111.

[^Lanza3]: Id. at 1113.

[^Lanza4]: The Ninth Circuit Court of Appeals rejected the concern in *Scorpio* that the "lawfully made under this title" language was intended to prevent extraterritorial application of the statute. The court agreed with *Parfums Givenchy, Inc. v. C & C Beauty Sales, Inc.*, 832 F. Supp. 1378, 1386 (C.D. Cal. 1993), that the impact of an importation is domestic, not extraterritorial. Therefore, the copyright holder in the United States is deprived of the opportunity to make a sale, and the importation is distribution in domestic commerce.

[^Lanza5]: *L'anza Research Int'l, Inc.*, 98 F.3d at 1114.

[^Lanza6]: Id. at 1116.
is being denied the full U.S. value of those sales. The U.S. copyright holder has, in effect, lost $7 per sale.

The L'anza court found this analysis compelling. The court did not find the location of production to be a relevant consideration in its decision. Even though the merchandise was manufactured in the United States and sold by L'anza, the unauthorized importations prevented L'anza from controlling the distribution of its product in the United States. This lack of control, according to the court, is contrary to the purposes of the distribution right, first sale doctrine, and the importation right. The court distinguished Sebastian on the grounds that the prior case did not mention whether the sales in South Africa were at a discount, as was the case in L'anza. In addition, Sebastian did not recognize the loss of control of distribution and the downward force on resale prices as an evil Congress sought to remedy with section 602(a).

As a result of the split between the Third Circuit's decision in Sebastian and the Ninth Circuit decisions in Givenchy and L'anza, the U.S. Supreme Court announced June 2, 1997, that it would review L'anza.69

The structure of the Copyright Act indicates congressional intention to treat the importation right as separate from the domestic distribution right. Most evidently, the Copyright Act places the importation right in a completely distinct chapter. Unlike section 106, section 602 contains no reference to a limitation found in section 109. Thus, Congress appears to have intended to insulate the importation right from the limitation of the first sale doctrine.

Another argument in favor of finding that the first sale doctrine does not limit a copyright holder's importation right is that such a reading of the Copyright Act renders section 602 without effect. A circumstance in which a party outside the United States acquires merchandise for importation that was not the subject of a first sale is difficult to imagine. Thus, if the first sale doctrine applies to imports, section 602 will almost never apply.

Still, certain policy considerations favor finding that a first sale abroad avoids the restrictions of section 602. Specifically, the theory of exhaustion holds that once a sale occurs, the copyright holder is fully compensated for the work and has no further right to control it or profit from it. Applying the first sale doctrine globally promotes consistent worldwide pricing and intra-band competition in the U.S. market.

V. Section 337

An alternative avenue of protection for U.S. companies is available through the United States International Trade Commission (ITC). The ITC is an independent

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agency of the Federal Government. Section 337 of the Tariff Act of 1930 declares unlawful:

(B) The importation into the United States, the sale for importation, or the sale within the United States after importation by the owner, importer, or consignee, of articles that—

(i) infringe a valid and enforceable United States patent or a valid and enforceable United States copyright registered under Title 17; or

(ii) are made, produced, processed, or mined under, or by means of, a process covered by the claims of a valid and enforceable United States patent.

(C) The importation into the United States, the sale for importation, or the sale within the United States after importation by the owner, importer, or consignee, of articles that infringe a valid and enforceable United States trademark registered under the Trademark Act of 1946.

The ITC is required to investigate any alleged violation of section 337 and to complete the investigation “at the earliest practicable time” after giving public notice of the initiation of the investigation. The decision of the agency is made on the record created in proceedings before it under the Administrative Procedures Act. All legal and equitable defenses may be raised in a section 337 action and the respondent may raise counterclaims. If the ITC determines there is a violation, it may direct that the Customs Service exclude the offending articles from the United States. The ITC may also issue preliminary exclusion orders, orders to cease and desist, and orders that merchandise be seized. Every affirmative determination is transmitted to the president for review. The president may disapprove the determination for policy reasons.

Section 337 is most often invoked by owners of patents. Patent owners invoke section 337 for a number of reasons, but principally because the ITC can investi-
gate and resolve the matter more quickly and with less cost than an action in the
district courts. In addition, as will be discussed below, Customs has its own
administrative procedures for dealing with trademark violations at the border.
As a result, those issues are not often addressed in the ITC.

The ITC had a recent opportunity to address a grey-market trademark issue
involving agricultural tractors from Japan. In that case, the ITC decided to
review the Initial Determination of the Administrative Law Judge (ALJ) with
respect to whether the lack of English-language labels and manuals is a material
difference between the authorized and grey-market tractors. The ALJ reasoned
that because replacement labels are available in the United States, the lack of
labels at the time of importation and sale is not material. The ITC reversed the
decision and found that labels attached to a tractor are physical features and that
the lack of English-language labels is a material physical difference. Based on
this finding, the ITC issued a general exclusion order prohibiting the importation
of grey-market tractors.

For a sample copyright analysis by the ITC, see Certain Soft Sculpture Dolls
Popularly Known as “Cabbage Patch Kids,” Related Literature and Packaging
Therefor. In that case, the ALJ found that a sale by a licensee abroad does not
bar an action under section 602(a) of the Copyright Act for an unauthorized
importation. Thus, the ITC ordered that Cabbage Patch Kids from Spain with
Spanish-language adoption papers be barred from entering the United States.

VI. Customs Service Enforcement

A. Trademark

Section 1526 of Title 19 of the U.S. Code specifically empowers Customs to
enforce registered trademark rights at the border. The powers of Customs,

78. See Certain Agricultural Tractors Under 50 Power Take-off Horsepower, Int'l Trade C.
Pub. 3016 (March 1997).
79. The ALJ's opinion started with the premise that grey-market goods violate U.S. trademark
law when the imported goods differ in a material way from the goods authorized to be sold in the
United States. Such differences create confusion as to the source of the product and damage the
holder's goodwill. Id. Initial Determination at 21.
80. Id. Commission Opinion at 7.
81. Id. at 10.
82. A number of other issues were also before the ITC. One interesting question was whether
the general exclusion order should include a limitation permitting the importation of tractors bearing
a disclaimer identifying the tractors as being grey-market products. The ITC found it had authority
to fashion such an order, but it declined to do so in this case, principally because there was no way
to guarantee that the labels would remain affixed to the tractors after importation. Id. at 29.
83. Certain Soft Sculpture Dolls Popularly Known as “Cabbage Patch Kids,” Related Literature
and Packaging Therefore, Int'l Trade C. Pub. 1923 (1986).
84. Id. Initial Determination at 87.
85. Except as provided in subsection (d) of this section, it shall be unlawful to import
into the United States any merchandise of foreign manufacture if such merchandise,
or the label, sign, print, package, wrapper, or receptacle, bears a trademark owned
however, are limited. The statute clearly applies only to articles "of foreign manufacture" imported bearing registered trademarks "owned by a citizen of, or by a corporation or association created or organized within, the United States." Based on this language, Customs does not have a role in prohibiting, for trademark reasons, the importation of U.S.-manufactured articles exported and re-imported without the authority of the trademark holder. Those cases are better addressed under section 42 of the Lanham Act.

In order to secure Customs enforcement without the need to seek a court order, a trademark holder must record its registered trademark with Customs. Recordation requires the filing of an application, a status copy of the registration certificate from the Patent and Trademark Office (along with five copies), and a filing fee of $190 for each trademark class covered by the registration for which the applicant seeks recordation. The application includes information identifying the trademark holder and foreign entities authorized to use the mark. In addition, the application seeks information identifying the trademark holder's parent, subsidiary, or "other foreign company under common ownership or control which uses the trademark abroad." A recordation with Customs remains in effect for the term of the trademark. Customs also permits the recordation of trade names and trade styles in use for six months to identify the source of merchandise.

The Customs regulations state that merchandise bearing a mark that copies or simulates a recorded trademark or a mark that is identical to a U.S.-owned recorded mark is prohibited merchandise. In the case of copying or simulating marks, Customs is to deny entry to the goods, which are then subject to forfeiture. For identical marks, the goods are subject to seizure and forfeiture. In either case, the goods will not enter the U.S. market without the permission of the trademark holder.

by a citizen of, or by a corporation or association created or organized within, the United States, and registered in the Patent and Trademark Office by a person domiciled in the United States, under the provisions of sections 81 to 109 of title 15, and if a copy of the certificate of registration of such trademark is filed with the Secretary of the Treasury, in the manner provided in section 106 of said title 15, unless written consent of the owner of such trademark is produced at the time of making entry.

86. 19 C.F.R. § 133.3 (1997).
87. Id. § 133.2. The regulations define "[c]ommon ownership" as "individual or aggregate ownership of more than 50 percent of the business entity." "Common control" means effective control in policy and operations and is not necessarily synonymous with common ownership." Id.
88. Id. § 133.4.
89. See id. § 133, subpt. B.
90. Id. § 133.21. For purposes of this discussion, the distinction between seizure and a forfeiture is not relevant. In general terms, seized merchandise is held in Customs custody until a decision is made on its disposition by Customs or the courts. 19 U.S.C. § 1605 (1994). Forfeiture is a disposition that may result following seizure. In most cases, forfeited merchandise is sold at public auction. Id. § 1609. As a practical matter, Customs must seize the merchandise before it may be the subject of forfeiture. Therefore, the distinction drawn in the regulation appears to be without significance.
The regulations, however, contain significant exceptions for circumstances when the U.S. markholder is related to the foreign entity that applied the mark. The first exception is when both the U.S. and the foreign trademarks are owned by the same person or entity. The second exception is when the foreign and domestic trademark owners are parent and subsidiary, or otherwise under the same ownership or control. An exception used to be available for circumstances in which the trademark was applied abroad with the permission of the U.S. owner.

In *K Mart Corp. v. Cartier, Inc.*, the Supreme Court waded into the grey-market arena and weighed in on the exceptions set out in the regulations. The resulting opinion is somewhat confusing in that there are shifting majorities for various aspects of the case. In the end, the court upheld the first two exceptions as permissible interpretations of section 526 and invalidated the permitted use exception as inconsistent with the statute. Justice Brennan concurred with the decision on the permitted use exception, but dissented, stating that all three exceptions are valid. Justice Scalia dissented, stating that all three exceptions are invalid.

The court's short opinion by Justice Kennedy finds the statute to be ambiguous on two points. First, the statutory requirement that the trademark be owned by a U.S. entity does not clearly address the circumstance when the U.S. company is the wholly owned subsidiary of a foreign company. The statute can be read as excluding trademarks owned by such companies because the ownership really flows through to the foreign parent. The court found further ambiguity in the phrase "merchandise of foreign manufacture." According to the court, this phrase may refer to goods manufactured in a foreign country, goods manufactured by a foreign company, or goods manufactured in a foreign country by a foreign company. Given these perceived ambiguities, the court deferred to the long-held Customs interpretation of the statute and upheld the common ownership and control exceptions in the regulation. The court, however, found that the permitted use exception is inconsistent with the statute because the exception permits the importation of foreign-made goods bearing a mark clearly owned by a U.S. entity. Given this inconsistency with the statute, the court invalidated the regulation.

In his opinion, Justice Brennan agreed that the common ownership or control exceptions are valid and further argued that the permitted use exception is also valid. His basic reasoning was that the statute must be construed in the context

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91. 19 C.F.R. § 133.21(c)(1) (1997).
92. Id. § 133.21(c)(2). A third exception exists for cases when the offending mark is removed or obliterated prior to importation. Id. § 133.21(c)(4). None of these exceptions apply to counterfeit marks. Id. § 133.21(d).
94. Id. at 292.
95. Id.
96. Id.
of the appellate decision in Katzel. According to Justice Brennan, section 526 was Congress's hasty response to the circuit court's decision in Katzel, and the statute should be read as a limited attempt to reverse that decision. As a result, Justice Brennan did not read section 526 as extending to any situation in which the domestic party could control the activity of the foreign producer. Thus, when a domestic party is the parent or subsidiary of the foreign manufacturer or both are under common control, there is a means for the U.S. company to prevent the grey-market imports through its own business practices. This situation is distinct from Katzel, in which the U.S. company purchased trademark rights from an unrelated foreign producer and had no way to influence its sales or production decisions.

Justice Brennan supported his conclusion regarding the permitted use exception by reference to the theory of universality prevailing at the time of Katzel. Under that theory, a trademark cannot be the subject of a license and can only be transferred in conjunction with the sale of an ongoing business. Any attempt by a U.S. company to license its trademark to a foreign producer will, therefore, result in an abandonment of the trademark. According to Justice Brennan, when Congress passed section 526 it could not have intended to protect U.S. trademark holders from importations by their foreign licensees because the license would divest the U.S. company of its trademark. Based on this analysis, Justice Brennan believed that Customs properly interpreted the statute as exempting imports of goods made with the permission of the U.S. trademark holder.

Justice Scalia in his dissent found that the statute is not ambiguous as to the ownership of a trademark when the goods are produced abroad by an unincorporated division of the U.S. trademark owner or by that owner's foreign subsidiary. In either case, the owner is the U.S. party. Justice Scalia also rejected the notion that goods of foreign manufacture can be read to mean goods manufactured by a foreigner, rather than goods manufactured in a foreign country. As a result, Justice Scalia saw no ambiguity in that phrase. Given that analysis, Justice Scalia would invalidate the common ownership and control exceptions.

Turning to the permitted use exception, Justice Scalia also found no ambiguity in the statute. Goods manufactured abroad with the permission of the U.S. trade-

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100. K Mart Corp., 486 U.S. at 301-02.
101. Id. at 313 (citing Everett O. Fisk & Co. v. Fisk Teachers' Agency, Inc., 3 F.2d 7, 9 (8th Cir. 1924)). This decision was based on the notion that a trademark identified the source of the merchandise. Any production by a party other than the trademark holder inevitably leads to consumer confusion as to the source of the goods.
102. Id. at 316-18.
103. Id. at 318-19. Justice Scalia did agree that the statute is ambiguous as to domestic subsidiaries of foreign corporations. Id.
104. Id.
mark owner are clearly goods of foreign manufacture and the trademark is clearly owned by a U.S. party and registered by a party domiciled in the United States. Thus, the plain language of the statute applies and the Customs regulations should be invalidated.105

The end result of K Mart is that the permitted use exception to section 526 found in the Customs regulations is invalid. The exceptions based on common ownership or control, however, remain in the regulations. Thus, a U.S. company that licenses an unrelated foreign manufacturer to produce goods may rely on section 526 of the Tariff Act to prevent unauthorized importations of those goods. However, when the foreign licensee is the parent or subsidiary of the U.S. trademark holder, or otherwise under common ownership or control, section 526 is of no avail.106

B. COPYRIGHT

Customs also has a process for recording copyrights registered with the Copyright Office.107 The fee to record a copyright is also $190, and the recordation is valid for a renewable period of twenty years.108 However, based on the language of section 602 of the Copyright Act, Customs takes the position that it has no role in enforcing copyrights when the goods were legally produced under the authority of the copyright holder.109 The Customs regulations reflect this position in the definition of "[i]nfringing copies" as 'piratical' articles, i.e., copies or phonorecords which are unlawfully made (without the authorization of the copyright owner).

The regulations go on to state that "[t]he importation of infringing copies or phonorecords of works copyrighted in the U.S. is prohibited by Customs. The importation of lawfully made copies is not a Customs violation."110

105. Id. at 323. Justice Scalia argued at length against Justice Brennan’s reading of the statute. Justice Scalia would not exempt goods produced by foreign licensees based on the context of the trademark law of 1920, on the theory that had the Congress of that time predicted modern trademark law, it would have added an exception to the statute. Id. at 324.

106. For example, in Yamaha Corp. of Am. v. ABC Int'l Traders Corp., 703 F. Supp. 1398 (C.D. Cal. 1988), aff'd, 940 F.2d 1537 (9th Cir. 1991), the plaintiff was the wholly owned U.S. subsidiary of Yamaha of Japan. The plaintiff sought to use section 526 to prevent the unauthorized importation of genuine Yamaha audio equipment manufactured and sold in Japan. The district court denied relief on the basis of the affiliate exception of the Customs regulations, stating that Customs adopted a reasonable interpretation of the statute. The court relied heavily on NEC Electronics for the proposition that Yamaha-Japan should not be permitted to use U.S. trademark law as a tool to enforce worldwide price discrimination.


108. Id. §§ 133.33(b), 133.34(b).

109. In a case where the making of the copies or phonorecords would have constituted an infringement of copyright if this title had been applicable, their importation is prohibited. In a case where the copies or phonorecords were lawfully made, the United States Customs Service has no authority to prevent their importation.

110. 19 C.F.R. § 133.42(a) (1997).

111. Id. § 133.42(b).
Thus, Customs only enforces copyrights when the goods are shown to be piratical in nature. Therefore, U.S. companies seeking to enforce copyrights against lawfully made imported copies must seek an injunction from a district court or an exclusion order from the ITC.

VII. State Law

The principal state law theory U.S. companies use to combat grey-market imports is based on the tort of intentional interference with contract. The parameters of this tort are set out in section 766A of the Restatement of Torts. The application of this tort to the grey-market context is best illustrated by *Railway Express Agency, Inc. v. Super Scale Models, Ltd.* In that case, the plaintiff entered into an agreement with the German manufacturer of toy trains to be the exclusive U.S. distributor of the toys. Despite that agreement, defendant Super Scale purchased genuine toy trains in Europe and imported them without the manufacturer's authorization. Railway Express Agency (REA) claimed that Super Scale knew REA was the exclusive authorized distributor of the toy trains in the United States, but nevertheless continued to import and sell the trains in competition with REA. That intentional conduct allegedly diminished the value of REA's contract and made its performance more burdensome.

Applying Wisconsin law, the Seventh Circuit found that REA must prove both that Super Scale intentionally interfered with its contract and that the performance of the contract was made more burdensome. The court held that REA failed to prove Super Scale's conduct made its contract more burdensome. For example, REA failed to show Super Scale harmed its goodwill by selling inferior products or decreased its profits by selling to established REA customers. Having failed to meet its burden, the court affirmed the dismissal of REA's case. Despite the negative result, *Railway Express* clearly sets out the fact issues facing a U.S. company seeking to rely on a cause of action based on intentional interference with contract.

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112. One who intentionally and improperly interferes with the performance of a contract . . . between another and a third person, by preventing the other from performing the contract or causing his performance to be more expensive or burdensome, is subject to liability to the other for the pecuniary loss resulting to him. *Restatement (Second) of Torts* § 766A (1979).


114. *Id.* at 139.

115. *Id.*

116. *Id.*

117. *Id.* at 140-41.

Contract law may also provide avenues of relief. In *Roberts v. Moore*, the plaintiff sold his Mercedes to the defendant who, two days later, took it to a Mercedes dealer for service. The dealership informed the defendant that the vehicle was a grey-market good and that the dealership would not service it. Based on this information (and undisclosed body work), defendant stopped payment on his check and attempted to return the vehicle to the seller. The plaintiff sued to enforce the contract.\(^{120}\)

The defendant asserted the contract was void due, in part, to the plaintiff's failure to disclose the material fact that the vehicle was not intended for sale in the United States and would not be serviced by U.S. Mercedes dealers. The trial court granted summary judgment in favor of the plaintiff on the issue of liability. The appellate court, however, found a material issue of fact as to whether the seller knew the vehicle was a grey-market product and whether he intentionally concealed that fact. The court held that, if proven, those facts give the buyer a basis on which to repudiate the contract. If neither party knew the car to be from the grey-market, the court could declare the contract voidable or subject to reformation due to mistake.\(^{121}\) Clearly, this case represents more of a consumer response to the grey-market phenomenon and may not be easily translated to a cause of action to protect a U.S. corporation facing grey-market competition. Nevertheless, when a retailer inadvertently purchases grey-market goods, this theory presents a means of voiding the contract.

Another contract theory is based on fraudulent inducement to contract. This theory is applicable when the U.S. or foreign vendor seeks assurances from its purchaser that it will not sell the goods in the U.S. market. If the goods are later found in the United States and the vendor can show the buyer had the intention to sell in the United States at the time of the sale, there may be a cause of action.\(^{122}\)

Finally, various state consumer protection laws may protect individuals against the inadvertent purchase of grey-market goods. Both New York and California have statutes specifically requiring that retailers selling grey-market goods clearly identify the products as such.\(^{123}\) The New York law requires that retailers selling grey-market merchandise conspicuously post a notice that the merchandise is not (1) accompanied by the manufacturer's warranty, (2) accompanied by instructions in English, or (3) eligible for manufacturer's rebates. The same disclosure must be made in any written advertising. Any person purchasing grey-market goods from a dealer who fails to post the proper notice may obtain a refund of the sales price for up to twenty days from the date of sale. The statute provides that the Attorney General may seek an injunction to prevent further violations and may

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120. Id. at 384.
121. Id. at 385.
122. See, e.g., Johnson & Johnson Prods. v. DAL Int'l Trading Co., 798 F.2d 100 (3d Cir. 1986).
123. N.Y. GEN. BUS. LAW § 218-aa (McKinney 1997); CAL. CIV. CODE § 1797.86 (West 1996).
seek a civil penalty of up to $500 per violation. The California statute is similar, although it requires additional disclosures relating to compatibility with U.S. electrical and broadcast standards, and the availability of replacement parts and accessories.\(^{124}\)

**VIII. Strategies**

**A. REGISTER AND RECORD TRADEMARKS AND COPYRIGHTS**

Every U.S. company selling products under a trademark should ensure it has properly registered the trademark with the U.S. Patent and Trademark Office. Registered trademarks and trade names should also be recorded with Customs to permit that agency to assist in the border enforcement of the company’s intellectual property rights. While the affiliate exceptions found in the Customs regulations provide wide gaps in the assistance available from that agency, the effectiveness of Customs enforcement should not be overlooked. Copyrights should also be registered with the Copyright Office and recorded with Customs. Customs, however, will not prohibit the unauthorized importation of lawfully made copies or phonorecords. Copyright holders will have to wait until the Supreme Court resolves *L’anza* to know the full scope of protection available to them under the Copyright Act.

**B. CONSIDER A SECTION 337 ACTION**

An action before the ITC based on section 337 can be an effective means of barring imports that infringe a U.S. trademark or copyright. These actions are often faster and less expensive than a comparable district court action that results in a similar remedy.

**C. MANUFACTURE PRODUCTS TO DIFFERENT SPECIFICATIONS TO CREATE MATERIAL DIFFERENCES**

In order to protect their ability to make a Lanham Act claim of trademark infringement, manufacturers should, whenever practical, produce goods for foreign distribution to different specifications. The threshold for a material difference between the authorized and unauthorized product is very low. As a result, a visible difference in labeling, product color, or ingredients may be sufficient to support a claim for trademark infringement by unauthorized imports.

**D. MARK PRODUCTS TO IDENTIFY DISTRIBUTORS**

To assist in identifying parties making unauthorized sales into the United States, manufacturers should mark their products to identify distributors. Identification

can often be accomplished through the use of lot numbers on packaging. Knowing which distributors are responsible for supplying grey-market retailers can be of assistance in choosing future distributors and in pursuing claims against those that violate distribution agreements.

E. **INCLUDE LIQUIDATED DAMAGES CLAUSES IN CONTRACTS WITH DISTRIBUTORS**

To further discourage the diversion of goods sold for export or goods produced abroad, manufacturers are advised to include liquidated damages clauses in distribution agreements. These clauses require the payment of a pre-set amount of damages in the event that goods sold to that distributor are found to be available in the U.S. market, or otherwise outside the limited geographic region of the distributorship. Such a clause shifts the burden of enforcement to the distributor, who must then ensure that its customers do not sell into the grey-market.

F. **DEVELOP DIFFERENTIATED DOMESTIC GOODWILL**

When product differences are not possible, U.S. authorized sellers should develop independent goodwill. Differentiating goodwill requires marketing the U.S. entity as the source of the product and establishing programs to develop recognition of the U.S. entity as distinct from the foreign manufacturer. Programs such as customer training seminars, dealer support programs, and brand name advertising can be helpful.

G. **CONSIDER STATE LAW**

Finally, manufacturers should not overlook causes of action based on state contract, tort, or consumer protection law.