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Destined to Remain Grey: The Eternal Recurrence of Parallel Imports

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As the world's largest single market with enormous potential for consumer spending, the United States consistently has been the primary target for grey-market imports. The legal limitations imposed on parallel imports in the United States are therefore of great interest to U.S. and foreign importers and exporters alike. This article first analyzes grey-market regulation in the United States, particularly underscoring important deficiencies and inconsistencies in current law that remain notwithstanding recent judicial decisions, including a key Supreme Court case. The article then discusses ancillary doctrines relevant to grey-market disputes and examines several recently proposed legislative initiatives. A critical examination of the competing jurisprudential and economic rationales for supporting or opposing grey markets and a brief comparative treatment of parallel imports in several countries follow. The article concludes with practical suggestions for appropriate legislation in order to cure the misleading imprecisions in current law and render grey-market regulations more responsive to the policy concerns and economic problems they were designed to resolve.

I. The Grey-Market Legal Framework

Parallel imports, or grey-market goods, are goods manufactured outside the target country bearing trademarks duly registered in their country of manufacture

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that are sold in the target country in competition with the same goods produced by the target country's authorized manufacturers or distributors. The value of the license to use or own the domestic trademark is eroded by the foreign competition, which introduces an apparently identical foreign product bearing the same trademark as the product sold by the domestic licensee.

Applicable case law, statutes, and regulations have tended to distinguish between several types of parallel imports. The most prevalent type occurs when a domestic entity licenses or purchases a foreign trademark for certain products only to find that independent third parties import goods bearing identical trademarks. In the second variant, a domestic trademark owner licenses a foreign importer to use and register the trademark in that foreign country, and the foreign licensee sells products bearing the licensed trademarks in the licensor's market. In the third permutation, the domestic licensee or owner of the foreign trademark is a corporate affiliate, or is subject to the control, of the licensor, which sells the foreign-made products bearing the same trademark in competition with its affiliate licensee.

The statutory anchors for parallel import claims are section 42 of the Lanham Act[1] (section 42 or Lanham Act) and section 526 of the Tariff Act of 1930[2] (section 526 or Tariff Act). Section 526 prohibits the importation of goods bearing a properly registered U.S. trademark owned by a U.S. entity. Section 42 prohibits the importation of goods that copy or simulate a registered U.S. trademark. The United States Customs Service (Customs) issued one set of regulations to enforce both statutes.

A. SECTION 526

Section 526 was enacted in response to *A. Bourjois & Co. v. Katzel.*[3] Section 526 expressly renders unlawful the importation into the United States of any goods of foreign manufacture bearing a registered trademark owned by a U.S. entity without the trademark owner's written permission. Goods imported in

1. Lanham Act § 42, 15 U.S.C. § 1124 (1988).
2. Tariff Act of 1930, § 526, 19 U.S.C. § 1526 (1988).
3. 275 F. 539 (2d Cir. 1921), *rev'd*, 260 U.S. 689 (1923). In *Katzel*, plaintiff purchased the domestic business, trademark and goodwill of a French manufacturer which manufactured JAVA, a cosmetic face powder. Plaintiff also invested heavily in order to develop goodwill for the product in the United States. When a third party retailer purchased genuine JAVA products abroad and sold them in the United States without plaintiff's authorization, plaintiff sued under the Trademark Act of 1905. The Court of Appeals for the Second Circuit reversed a preliminary judgment for the plaintiff because the goods were genuine products of the French trademark owner, thereby allowing defendant to import genuine JAVA products without the consent of the U.S. trademark owner. Congress responded by enacting section 526. The Supreme Court subsequently reversed the lower court's decision and, without making reference to section 526, found that the unauthorized importation and sale of the goods violated sections 17 and 19 of the Trademark Act of 1920 (the predecessor of the Lanham Act). *See Katzel*, 260 U.S. at 689.

violation of this provision are subject to seizure and forfeiture.[4] Importers violating the measure also are subject to money damages for trademark infringement and injunctive relief, which may require re-export of the goods or obliteration of the trademark.[5]

Notwithstanding section 526's unequivocal blanket prohibition of parallel imports, Customs' implementing regulations (Regulations) provide for certain exceptions whose validity repeatedly has been challenged in court by trademark owners. Customs' exceptions sanction the importation of foreign-made goods bearing trademarks identical to registered U.S. marks: if the foreign and U.S. trademarks are owned by the same entity; or if both the foreign and U.S. trademark owners are parent or subsidiary corporations or companies otherwise subject to common ownership and control (Affiliation Exception); or if the goods are imported by a foreign manufacturer who was authorized to use the mark by the U.S. trademark owner (Authorized Use Exception).[6]

The Affiliation Exception expresses antimonopoly concerns. Also, since affiliated entities are deemed to have compatible interests, allowing infringement claims in this context would be tantamount to endorsing the nonsensical possibility of self-infringement. As a matter of contract, finally, if the entities are commonly controlled, one entity cannot legitimately claim that it lost benefits for which it bargained and that it might have expected the other entity not to circumvent by directly or indirectly selling the products in the same territory. Thus, the Affiliation Exception properly reflects the premise that a commonly controlled or affiliated group of entities cannot be deemed to compete against itself.

Several circuit court decisions have upheld the Regulations in suits brought by owners of U.S. trademarks in foreign-made goods who were affiliated with the foreign manufacturer of the same product. In *Vivitar Corp. v. United States*[7] Vivitar, a U.S. corporation owning the U.S. registered trademark "VIVITAR"[8] authorized foreign firms to manufacture photographic equipment with its registered trademark.[9] Vivitar sought to compel Customs to prohibit importation of any foreign photographic equipment bearing its registered trademark without its

4. 19 U.S.C. § 1526(b) (1988).

5. *Id.* § 1526(c).

6. 19 C.F.R. § 133.21(c) (1991) provides in part:

> (c) Restrictions not applicable. The restrictions set forth in paragraphs (a) and (b) of this section [§ 526] do not apply to imported articles when:
>
> (1) Both the foreign and the U.S. trademark or trade name are owned by the same person or business entity;
>
> (2) The foreign and domestic trademark or trade name owners are parent and subsidiary companies or are otherwise subject to common ownership or control . . .
>
> (3) [Reserved]. Prior to this deletion, § 131.21 (c)(3) read: "The articles of foreign manufacture bear a recorded trademark or trade name applied under authorization of the U.S. owner."

Formerly known as the Authorized Use Exception, section 133.21(c) (3) was deleted by Customs in response to K Mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988).

7. 761 F.2d 1552 (Fed. Cir. 1985), *cert denied*, 474 U.S. 1055 (1986).

8. *Id.* at 1555.

9. *Id.* at 1556.

specific consent. Vivitar argued that section 526 gave it an absolute right to bar the importation of any good imported without its consent that bore the same trademark as that owned by Vivitar notwithstanding the exceptions to the Regulations.[10] The Federal Circuit Court concluded that Customs was not required to provide for automatic exclusion beyond that set forth in the Regulations.[11] The court held the Regulations to be "valid but not controlling" with respect to the scope of protection afforded a U.S. trademark owner, leaving the courts to determine whether the goods should be excluded in a given grey-market situation and permitting Customs to enforce the court's decision.[12]

In *Olympus*,[13] the Second Circuit upheld the Regulations on different grounds. Olympus, the U.S. subsidiary of the Japanese company that manufactured cameras and other accessories of the same brand, challenged the validity of the Regulations. While the court found "the regulation[s] of questionable wisdom,"[14] the court disagreed with *Vivitar* that the Regulations were not sufficiently consistent throughout the years to warrant a finding of "longstanding administrative interpretation" of the statute.[15] More significantly, the court also held that Customs' interpretation of the statute did not limit the reach of section 526, but only limited Customs' duty to enforce the section by excluding goods.[16] Markholders, reminded the court, still have the right under section 526(c) to pursue private remedies against importers, notwithstanding Customs' failure to exclude the goods.[17]

An opposite result was reached by the Circuit Court of Appeals for the District of Columbia in *COPIAT*,[18] which involved two appeals of retailers engaged in parallel importing. The court concluded that the Regulations were unlawful since they were inconsistent with the statute and congressional intent and, in the alternative, unreasonable. Examining the legislative history of section 526, and underscoring the inherently territorial nature of trademark law, the court concluded that the statute "confers an absolute, unqualified property right upon American companies that own registered trademarks."[19] The court found that grey-market goods are excludable under section 526, without regard to trademark infringement, and under section 42, as infringing merchandise.[20]

10. *Id.* at 1561.
11. *Id.* at 1555.
12. *Id.* at 1569, 1970.
13. Olympus Corp. v. United States, 792 F.2d 315 (2d Cir.), *cert. denied*, 486 U.S. 1042 (1986).
14. *Id* at 320.
15. *Id.* at 319-20.
16. *Id.* at 320.
17. *Id.*
18. Coalition to Preserve the Integrity of American Trademarkers v. United States (COPIAT), 790 F.2d 903 (D.C. Cir. 1986).
19. *Id.* at 910.
20. *Id.* at 918.

The Supreme Court resolved the conflict of authority in *K Mart Corp. v. Cartier, Inc.*,[21] in which the Court examined the validity of the Regulations after granting certiorari in *COPIAT*. The Court upheld sections 133.21(c) (1) and (2) of the Regulations, the Affiliation Exception, and invalidated the Authorized Use Exception. The Court reasoned that "[u]nder no reasonable construction of the statutory language can goods made in a foreign country by an independent foreign manufacturer be removed from the purview of the statute."[22] Significantly, however, the Court did not rule on whether the Regulations also are generally consistent with the Lanham Act and, most importantly, whether the Affiliation Exception applies regardless of how similar or different parallel imports are from the domestic products.

Customs ultimately removed the Authorized Use Exception without regard to its validity under the Lanham Act. Responding to comment on the proposed removal, Customs stated:

> It is because the [Supreme] Court did not reach the Lanham Act . . . in its decision and place any restrictions on Customs' interpretation of Section 42 of that Act that comments were solicited on this issue. In this rulemaking, Customs is exercising its authority to implement both the Tariff and Lanham Acts. The fact that the [Supreme] Court did not address the validity of 133.21(c) (3) with regard to one of those acts, while holding it invalid with regard to the other, does not create a right to import goods which would be barred under the provision which was addressed.[23]

Ironically, what at the time may have been applauded as an appropriate exercise in judicial restraint has returned matters to square one in perfect precision, thereby underscoring the Sisyphean nature of U.S. grey-market law. For, as a result of the Supreme Court's failure to reach the Lanham Act it is now no more obvious than before *K Mart* to what extent and under which circumstances trademark law provides protection to U.S. trademark owners from parallel importers.

B. The Lanham Act

Section 42 of the Lanham Act prohibits the importation of merchandise that copies or simulates a registered trademark.[24] Section 32 of the Lanham Act (section 32) provides the registered trademark owner with recourse against anyone who, without the owner's consent, uses a "reproduction, counterfeit, copy

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21. 486 U.S. 281 (1988).
22. *Id.* at 294.
23. 55 Fed. Reg. 52,040, 52,041 (1990).
24. Section 42, *supra* note 1, provides in part:

> Except as provided in subsection (d) of section 1526 of title 19, no article of imported merchandise which shall copy or simulate the name of [any merchandise of] any domestic manufacture, or manufacturer, or trader . . . or which shall copy or simulate a trademark registered in accordance with the provisions of this chapter . . . shall be admitted to entry at any customhouse of the United States.

15 U.S.C. § 1124 (1988).

or colorable imitation'' of the mark in such a way as ''is likely to cause confusion, or to cause mistake, or to deceive.''[25]

Several courts have dismissed grey-market cases based on section 42, holding that this section does not apply to goods bearing genuine marks.[26] In *Monte Carlo Shirt v. Daewood International*[27] the Ninth Circuit held that an action under common law trademark principles was insufficient because the plaintiff could not demonstrate that there was confusion as to the source of the merchandise.[28] In this case, a contract under which plaintiff had contracted with defendant to manufacture shirts was canceled. Defendant subsequently sold the shirts under plaintiff's brand name. The court concluded that defendant's shirts were not imitations of plaintiff's products since they were the same shirts that plaintiff had contracted defendant to manufacture. Similarly, district courts have found in several cases that genuine products manufactured for trademark owners did not violate the Lanham Act.[29]

In *Bell & Howell: Mamiya Co. v. Masel Supply Co.*[30] the court issued an injunction after it found that the parallel importer had violated sections 32 and 42 by importing cameras and selling them under the ''Mamiya'' trademark. The court found a distinct goodwill based on the territoriality concept despite the affiliate relationship between the two companies.[31] The court concluded that the grey-market imports could cause customer confusion and damage the reputation and goodwill developed by the U.S. distributor.[32] The Second Circuit, however, ultimately vacated the district court's injunction for lack of evidence that the grey-market goods were actually inferior to those sold by the U.S. distributor and, thus, were injuring its reputation.[33]

In *Original Appalachian Artworks v. Granada Electronics Inc.*[34] the Second Circuit found a violation of section 32 where an unaffiliated licensee provided different goods under the same trademark as the authorized distributor. The

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25. *Id.* § 1114(1).

26. *See* Jamie S. Gorelick & Rory K. Littloe, *The Case for Parallel Importation*, 11 N.C.J. INT'L L. & COM. REG. 205, 224–25 (1986). Nevertheless, the Supreme Court, as early as 1923, suggested that grey-market goods ''copy or simulate'' trademarked goods marketed by the U.S. trademark owner. *See* Scott D. Gilbert et al., *Federal Trademark Law and the Grey Market: The Need for a Cohesive Policy*, 18 LAW & POL'Y INT'L BUS. 103, 117–19 (1986); A. Bourjois & Co. v. Aldridge, 263 U.S. 675 (1923) (per curiam).

27. 707 F.2d 1054 (9th Cir. 1983).

28. *Id.* at 1058.

29. *See, e.g.*, El Greco Leather Products Co. v. Shoe World Inc., 599 F. Supp. 1380 (E.D.N.Y. 1984) (shoes manufactured by defendant for plaintiff were genuine, and their importation did not violate § § 32 and 43(3) of the Lanham Act), *rev'd*, 806 F.2d 332 (2d Cir. 1986) (shoes were not genuine as they were sold without owner's quality inspection); DEP Corp. v. Interstate Cigar Co., 622 F.2d 621 (2d Cir. 1980) (soap sold by defendant was genuine and not ''spurious'').

30. 548 F. Supp. 1063 (E.D.N.Y. 1982), *vacated*, 719 F.2d 42 (2d Cir. 1983).

31. 548 F. Supp. at 1070.

32. *Id.* at 1068.

33. Bell & Howell, 719 F.2d at 46.

34. 816 F.2d 68 (2d Cir. 1987).

owner of the trademark for Cabbage Patch dolls brought an infringement action against a grey-marketeer for importing dolls that were manufactured abroad under the owner's license. The court rejected defendant's argument that there could be no infringement because the owner controlled the trademark worldwide and held that defendant's argument "has some force in cases where the imported goods are identical to the domestic goods and are intended for sale in the United States."[35] Although the dolls acquired abroad by defendant were physically identical to the dolls sold by plaintiff in the United States, the court deemed the dolls to be different goods because the "adoption papers" of the grey-market dolls, which were part of the package, were in Spanish. Noting that the dolls had not been produced for sale in the United States, the court found that a likelihood of confusion existed between the two categories of dolls.

The Ninth Circuit's decision in *Cal ABCO*[36] stands for the proposition that in affiliate or common control situations the importation and sale of identical grey-market goods does not violate the Lanham Act.[37] In *Cal ABCO,* plaintiff was a U.S. wholly owned subsidiary that bought computer NEC brand chips from its Japanese parent company and sold them in the United States. "NEC" was a registered trademark in the United States and elsewhere. The defendant, ABCO, bought these chips from a foreign source and sold them in the United States in direct competition with the subsidiary. The issue was whether a U.S. subsidiary selling in the United States can prevail under sections 32 and 43(a) of the Lanham Act if another company, such as ABCO, buys the parent's identical goods abroad and sells them in the United States using the parent's true mark. The court reiterated previous decisions to the effect that "[t]rademark law generally does not reach the sale of genuine goods bearing a true mark even though such sale is without the mark owner's consent."[38] The court reasoned that trademark law is designed to prevent sellers from confusing or deceiving consumers about the origin or make of a product. Such confusion ordinarily does not exist when a genuine article bearing a true mark is sold.[39]

Different results, however, were reached in several other Circuit Court decisions. In *Lever Brothers,*[40] two affiliated corporations, one operating in the United States and the other in England, used the same words "Shield and Sunlight," as trademarks for materially different products.[41] Defendants directly or indirectly acquired the English products and imported them into the United

35. *Id.* at 73 (emphasis added).
36. NEC Electronics v. Cal Circuit ABCO, 810 F.2d 1506 (9th Cir.), *cert. denied,* 481 U.S. 851 (1987).
37. *Id.* at 1509-10.
38. *Id.* at 1509.
39. *Id.* at 1509, *citing* the Supreme Court in Prestonettes, Inc. v. Coty, 264 U.S. 359, 368–69 (1924), and Monte Carlo Shirt v. Daewood Int'l, 704 F.2d 1054, 1058 (9th Cir. 1983).
40. Lever Bros. Co. v. United States, 877 F.2d 101 (D.C. Cir. 1989).
41. *Id.* at 102.

States, despite the objection of the U.S. affiliate.[42] Plaintiff claimed that Customs was bound to seize the imports under section 42.[43] Plaintiff contended that where affiliated domestic and foreign companies produce goods bearing the same trademark, but which are different in physical content, the foreign products copy or simulate the domestic trademark so that section 42 forbids their importation notwithstanding their affiliation.[44] Customs, relying on the Affiliation Exception, asserted that "[w]here the affiliation between producers exists, Customs regards as irrelevant both physical differences in the products and the domestic markholder's non-consent to importation."[45]

The District of Columbia Circuit Court of Appeals reversed the lower decision and opined that the "natural, virtually inevitable reading of Section 42 is that it bars foreign goods bearing a trademark identical to a valid U.S trademark but [which are] physically different, regardless of the trademarks' genuine character abroad or affiliation between the producing firms."[46] The court cautioned that its conclusion had to remain provisional as neither party had briefed the legislative history or administrative practice; it therefore remanded the case.[47] Significantly, one of the reasons the court did not reach a firm conclusion was that the Supreme Court in *K Mart* failed to evaluate the Affiliation Exception against an attack under section 42.

The "tentative"[48] reading adopted by the D.C. Circuit in this case was promptly construed as controlling by the U.S. District Court for the District of Columbia in *Yamaha Corporation of America v. United States,*[49] the U.S. District Court for New Jersey in *Ferrero U.S.A., Inc. v. Ozak Trading, Inc.* and the Third Circuit in affirming the district court's *Ferrero* decision.[50]

Ferrero also was a trademark infringement action where genuine goods, "TIC TAC" brand breath-mints, produced by an affiliated firm for a foreign market, were imported into the United States bearing a trademark identical to the valid U.S. trademark.[51] Plaintiff was the U.S. distributor for the mints. Defendant was a parallel importer of "TIC TAC" mints manufactured for distribution in the United Kingdom.[52] The foreign product was different in caloric content and size from the product distributed in the United States.[53] The district court, after

42. *Id.*
43. *Id.*
44. *Id.* at 103–04.
45. *Id.* at 104.
46. *Id.* at 111.
47. *Id.*
48. *Id.*
49. 745 F. Supp. 730 (D.D.C. 1990).
50. 753 F. Supp. 1240 (D.N.J.), *aff'd,* 935 F.2d 1281 (3d Cir. 1991).
51. *Id.* at 1241–42.
52. *Id.* at 1247.
53. *Id.* at 1243.

examining a number of similar cases,[54] was persuaded that although the grey-market goods involved were genuine, they contained differences sufficient to generate potential customer confusion about the source of the product. Based on its understanding of *Lever Brothers* and a footnote in the Third Circuit's decision in *Weil Ceramics,* the court seemed to propound a test whereby parallel imports would be banned if they were materially different from the domestic product.[55]

Cal ABCO probably can be reconciled with *Lever Brothers* and its progeny on the ground that the parallel imports in *Cal ABCO* were identical to the original goods, so that there really is not a split of authority in the application of the Lanham Act to affiliate entities. However, two gnawing uncertainties persist.

The first is whether and to what extent a manufacturer's or trademark owner's intent to distribute in the grey-market territory is probative, if not dispositive. Such intent was an element in the Second Circuit's decision in *Artworks,*[56] and the U.S. District Court for the Southern District of New York recently employed the same test.[57] However, in *Lever Brothers* and *Ferrero,* the D.C. and Third Circuits, respectively, only placed a premium on the degree of similarity of the goods in question.

The second unresolved issue is how different the grey-market goods must be from the authorized ones in order to run afoul of the Lanham Act. District courts in the Third and D.C. Circuits have looked to material differences between goods,[58] and the Second Circuit court looked to material differences in *Artworks.*[59] Interestingly, however, the D.C. Circuit in *Lever Brothers,* the case most frequently cited as the source for the materiality standard, actually framed its decision in terms of physical difference between the products.[60]

The distinction between material and physical differences may not have been intended to be more than semantic, but the application of these two terms can produce substantive differences. What is physically different may not necessarily be materially different and vice versa. The Cabbage Patch dolls in *Artworks,* for example, were found to be materially different. The difference was material not because the dolls themselves where physically different, but because there was no "birthday card" system for the grey-market dolls and their adoption papers

54. *Id.* at 1246; *see also* Weil Ceramics and Glass, Inc. v. Dash, 878 F.2d 659, 668 (3d Cir.), *cert. denied,* 493 U.S. 853 (1989).

55. Ferrero U.S.A., Inc. v. Ozak Trading, Inc., 753 F. Supp. 1240, 1247 (D.N.J.), *aff'd,* 935 F.2d 1281 (3d Cir. 1991).

56. Original Appalachian Artworks v. Granada Elecs. Inc., 816 F.2d 68, 73 (2d Cir. 1987).

57. *See* Atkins Holdings Ltd. v. English Discounts, 729 F. Supp. 945 (S.D.N.Y. 1990).

58. *Ferrero,* 753 F. Supp. at 1247; Yamaha Corp. of Am. v. United States, 745 F. Supp. 730 (D.D.C. 1990).

59. *Appalachian Artworks,* 816 F.2d at 72–73.

60. The *Lever Brothers* court stated in its factual recitation that the goods were materially different. Lever Bros. Co. v. United States, 877 F.2d 101, 102–03 (D.C. Cir. 1990). The court, however, stressed the "physical" differences between the products on four occasions. *Id.* at 103, 106–07, 111.

were in Spanish. In *Lever Brothers* the products differed physically, but whether the lather-generating capacity of the soap at issue, for example, is material can only be answered by the individual consumer. And what may be material for the consumer in the country of origin may not be material to the U.S. consumer. Also, in *Ferrero* the physical differences between the original "TIC TAC" mints and the grey-market imports were numerous and included size, packaging, labeling, and composition. Is any one of these factors sufficient or necessary for a finding of material difference, or should a court really be concerned with the cumulative impact of these differences? Moreover, is the judgment of materiality a qualitative or quantitative one? Remarkably, the case law provides no guidance whatsoever on these important questions.

II. Ancillary Doctrines

In addition to section 526 and Lanham Act claims and defenses, domestic and foreign trademark owners should be aware of several alternative legal theories and causes of action that are frequently raised in grey-market disputes.

A. Copyright Infringement

A trademark owner may prefer to characterize an infringement claim as one of the copyright rather than trademark variety, when it is difficult to establish the likelihood of confusion necessary for trademark infringement.[61] Copyright law also provides an alternative in cases where private actions under section 526 are unlikely to succeed if Customs determines that the parallel import is protected by the Affiliation Exception.

A copyright claim against a grey-marketeer can be brought only if the product itself is copyrightable[62] as a work of authorship (for example, books, records, and video games) or if something on the product is copyrightable (for example, labels or instructions).[63] Importing copies and phonorecords of copyrighted work without the owner's permission violates section 106(3) of the Copyright Act. Section 106(3) creates the exclusive right "to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending."[64] This distribution right gives the copyright owner the right to control the first public distribution of the work. Additionally, section 602(a) of the Copyright Act provides that importation of goods into the United

61. *See* David A. Gerber, *Litigating the Copyright "Gray Market" Case*, *in* GREY MARKETS AND PARALLEL IMPORTATION 269 (Practicing Law Institute Series No. 217, 1986). The Copyright Act's principles of joint liability and a variety of other remedies under the Act make the copyright claim more attractive. Copyright Act, 17 U.S.C. § 101 *et seq.* (1988).

62. *See* 17 U.S.C. § 102 (1988).

63. Section 102(a)(5) of the Copyright Act includes prints and labels used for articles of merchandise under the general protection conferred to pictorial, graphic and sculptural works. MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 2.08(G) (1963 & Supp. 1990).

64. 17 U.S.C. § 106(3) (1988).

States without the authority of the copyright owner is an infringement of the exclusive right to distribute copies or phonorecords.[65] Many of the goods protected under this provision incorporate a label,[66] instruction sheet,[67] or some other material that is copyrightable.[68] However, section 109(a) of the Copyright Act[69] creates a basic exception to a copyright owner's distribution right known as the "first sale doctrine," which limits the copyright owner's control over copies of the work to their first sale or transfer.[70] Once a sale has occurred, the doctrine allows the new owner to treat the object as his or her own.

The District Court for the Eastern District of Pennsylvania confronted the evident conflict between the first sale doctrine and section 602(a) in *Columbia Broadcasting System v. Scorpio Music Distributors.*[71] In this case CBS, a musical copyright owner, authorized the manufacture and sale of certain records in the Philippines. Through an intermediate buyer in the Philippines, defendant imported 6,000 of these records into the United States. When CBS sued for infringement of its distribution rights under section 602, defendant asserted that the sale of the records exhausted CBS's distribution rights under the first sale doctrine. The court rejected this defense since it would vitiate the section 602 prohibition against importation, without the copyright owner's consent, of copies made and sold abroad. In so ruling, the court limited the scope of the first sale doctrine to situations where copies have been legally manufactured and sold within the United States. Other cases[72] have confirmed *Scorpio,* enabling the

65. This subsection does not apply to (i) "importation of copies or phonorecords under the authority or for sale of the U.S. Government," *id.* § 602(a) (1); (ii) "importation, for the private use of the importer and not for distribution," *id.* § 602(a)(2); and (iii) "importation by or for an organization operated for scholarly, educational, or religious purposes and not for private gain," *id.* § 602(a)(3).

66. *E.g.*, Cosmair, Inc. v. Dynamic Enterprises, Inc., 226 U.S.P.Q. (BNA) 344 (S.D. Fla. 1985) (perfume with copyrighted label). A label is understood to refer to artistic and/or literary work imprinted or attached to an article of merchandise. *See* NIMMER, *supra* note 63, § 2.08(G)(1).

67. *See* Original Appalachian Artworks v. Grenada Elecs. Inc., 816 F.2d 68 (2d Cir. 1987) (grey-market Cabbage Patch Kids dolls were lacking English language "adoption papers").

68. NIMMER, *supra* note 63, § 8.11(B).

69. 17 U.S.C. § 109(a) (1988).

70. Section 109(a) 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(a).

71. 569 F. Supp. 47 (E.D. Pa. 1983).

72. *See, e.g.*, T. B. Harms Co. v. Jem Records, Inc., 655 F. Supp. 1575 (D.N.J. 1987) (court found infringement when phonorecords manufactured under license in New Zealand were imported into the United States); Hearst Corp. v. Stark, 639 F. Supp. 970 (N.D. Cal. 1986) (court found an infringement, held that the first sale doctrine did not modify the importation restraints of section 602(a) (with respect to books that were lawfully made in England and imported into the United States), and rejected both a First Amendment defense for the importation of out-of-print books and an assertion that the copyright owners' exclusive licensing agreements violated antitrust law); Nintendo of Am., Inc. v. Elcon Indus., 564 F. Supp. 937 (E.D. Mich. 1982) (court enjoined the defendants from distributing electronic audio-visual games in Japan under a license expressly limited

copyright owner to exercise control over copies of the work that enter the U.S. market in competition with copies legally manufactured and distributed within the United States.

Sebastian[73] is the most recent case on point decided by a circuit court. In this case, a U.S. manufacturer of hair care products with copyrighted labels brought a copyright infringement action against a foreign purchaser of the products that reshipped them to the United States for resale.[74] The district court held that the exclusive importation right under section 602 superseded the first sale doctrine. The Third Circuit Court of Appeals reversed, holding that the manufacturer, having sold its goods with copyright labels to foreign distributors, was barred by the first sale doctrine from establishing infringement through an unauthorized importation.[75] Although the court distinguished the facts before it from *Scorpio* and *Harms,* where the copies were produced abroad and the sales occurred overseas, it still held that the place of sale is not the critical factor in determining whether section 602(a) governs.[76] The court reasoned:

> [S]ection 602(a) does not purport to create a right in addition to those conferred by Section 106(3), but states that unauthorized importation is an infringement of "the exclusive [Section 106(3)] right to distribute copies." Because that exclusive right is specifically limited by the first sale provisions of § 109(a), it necessarily follows that once transfer of ownership has canceled the distribution right to a copy, the right does not survive so as to be infringed by importation.[77]

The court presented two rationales in support of the first sale doctrine. The first was that although the first sale rule is statutory, the rule finds its origins in the common law aversion to limiting the alienation of personal property.[78] The second was that the copyright proprietor had received whatever reward it was entitled to in the purchase price.[79] Thus, the effectiveness of copyright claims aimed at barring grey-market imports remains in doubt.

B. Trademark Dilution

Dilution is a trademark doctrine protecting strong marks from their use by other parties even if there is no competition or likelihood of confusion. Dilution

to the territories of Japan). *But see* Cosmair, Inc. v. Dynamite Enters., Inc., 226 U.S.P.Q. (BNA) 344 (S.D. Fla. 1985) (court held that the first sale doctrine limits section 602 where Polo fragrances were manufactured in the United States and were re-imported).

73. Sebastian Int'l, Inc. v. Consumer Contacts Ltd., 847 F.2d 1093 (3d Cir. 1988), *rev'g* 664 F. Supp. 909 (D.N.J. 1987).

74. 847 F.2d at 1093.

75. *Id.* at 1094.

76. *Id.* at 1099.

77. *Id.*

78. *Id.* at 1096.

79. *Id.* at 1097 (citing Burke & Van Heusen, Inc. v. Arrow Drug, Inc., 233 F. Supp. 881, 884 (E.D. Pa. 1964); Platt & Monk v. Republic Graphics, Inc., 315 F.2d 847, 854 (2d Cir. 1963); Cosmair, Inc. v. Dynamite Enters., Inc. 226 U.S.P.Q. (BNA) 344 (S.D. Fla. 1985)); *see also* Stern, *Parallel Importation of Copyrighted Products into the U.S.,* 4 Eur. Intell. Prop. Rev. 119, 120 (1989).

laws provide a remedy for injury to the distinctive character of a trade name[80] and apply in cases where consumers may prefer certain products because the mark itself has acquired value as opposed to marks that identify a source valued by consumers. Although this injury differs from those protected against by trademark infringement statutes and traditional notions of unfair competition at common law, such as passing-off or likelihood of confusion, courts have not always distinguished these injuries.[81] In some cases courts have even required "proof of likelihood of confusion as a prerequisite for relief in dilution cases, notwithstanding contrary statutory language."[82] The trend, however, is towards recognition of dilution as a separate injury.[83]

The dilution doctrine has been codified in a number of states,[84] but there is no federal dilution cause of action. State statutes prohibit practices that confuse consumers with regard to the sources of goods, not the goods themselves. Most state antidilution statutes are comparable to section 12 of the Model State Trademark Bill that provides:[85]

> Likelihood of injury to business reputation or of dilution of the distinctive quality of a mark registered under this Act, or a mark valid at common law, or a trade name valid at common law, shall be ground for injunctive relief notwithstanding the absence of competition between the parties or the absence of confusion as to the source of goods or services.

The doctrine is most applicable when a subsequent user utilizes the trademark of a prior user for a dissimilar product and the likelihood of confusion of the products or sources is nonexistent. The use of the trademark by the subsequent user, however, will lessen the uniqueness of the prior user's mark with the possible result of undermining a strong mark.[86] Trademark owners may argue that grey-marketeers intend, and are likely, to mislead, confuse, and deceive the purchasing public, thereby causing injury to the business reputation of the mark and diluting the value of the products owned and registered by the trademark

80. Griffith B. Price, Jr., "Remedies When Planning Fails: Trademark Infringements, Lanham Act Section 43(a), Anti-Counterfeiting Act of 1984, Customs Service Remedies, and International Trade Commission Proceedings" in *The Commerce Department Speaks,* Douglas A. Riggs, Chairman, 570 PLI B4-6801 vol. 1, 324 (1987).

81. *Id.*

82. *Id.*

83. *See* Allied Maint. Corp. v. Allied Mech. Trades, Inc., 42 N.Y.2d 538, 399 N.Y.S.2d 628, 369 N.E.2d 1162 (1977); Sally Gee, Inc. v. Myra Hogan, Inc., 699 F.2d 621 (2d Cir. 1983) (plaintiff must show both strong distinctiveness and also "likelihood of dilution").

84. Antidilution statutes have been adopted in twenty-three states, including New York, New Jersey, and California. Some jurisdictions appear to have adopted the doctrine by judicial decree. *See* Miles J. Alexander, *Dilution—A Blessing or a Curse?: What Is It? How Do You Prove It? How Does It Fit in with Traditional Trademark Law?, in* CURRENT DEVELOPMENTS IN TRADEMARK LAW AND UNFAIR COMPETITION 297 (Practicing Law Institute Series No. 251, 1988).

85. *Id.*; *see also* the New York Anti-Dilution statute, N.Y. GEN. BUS. LAW § 368-d (McKinney 1984), which is similar to those of other states in that it disregards the requirement of competition and confusion between goods.

86. Holiday Inns, Inc. v. Holiday Out in America, 481 F.2d 445, 450 (5th Cir. 1973).

owners.[87] However, since in many cases grey-market goods are not inferior to the original goods, the dilution theory may be of only limited use in most grey-market situations.

C. Tortious Interference with Contractual Relations

The increasingly popular common law tort of interference with contractual relations may be found when one induces a third party to breach a contract with the plaintiff.[88] This cause of action is usually brought when the mark is not registered in the United States or when plaintiff is unable to establish injury by illegal grey-market importing under section 526.[89] The tort has four elements: existence of a valid contract, defendant's knowledge of that contract, defendant's intentional causing of breach, and damages.[90]

In *DEP Corp. v. Interstate Cigar Co.*,[91] plaintiff was the exclusive dealer of soap in the United States. Defendant bought the soap from a third party in Europe and sold it at a lower price in the United States.[92] On appeal, the Second Circuit suggested that plaintiff might have a cause of action for intentional interference with contractual relations as defendant interfered with plaintiff's exclusive distribution contract.[93] Recently, in *Railway Express Agency v. Super Scale Models, Ltd.*,[94] a toy train distributor sued a competitor for intentionally interfering with its contract with a German toy train manufacturer by rendering the contract less profitable to the distributor.[95] The mark was registered in Germany, but not in the United States.[96] Thus, plaintiff did not have a course of action under U.S. trademark laws. The Seventh Circuit held that plaintiff had to prove that defendant caused plaintiff's performance with the German toy manufacturer to become onerous or burdensome.[97] The court concluded that the exclusive distributor could have established the requisite damage, either by presenting evidence that defendant had sold an inferior product under the same trademark, or alternatively, by demonstrating that defendant made sales to plaintiff's existing clients.[98] Plaintiff made no such attempt, and the court dismissed his claim.[99]

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87. *See* Danielle G. Mazur, Note, *The Gray Market after K Mart: Shopping for Solutions*, 8 Cardozo Arts & Ent. L.J. 641, 673 (1990).

88. Restatement (Second) Of Torts § 766 (1977) provides:

> One who intentionally and improperly interferes with the performance of contract . . . between another and a third person by inducing or otherwise causing the third person not to perform the contract, is subject to liability to the other for the pecuniary loss resulting to the other from the failure of the third person to perform the contract.

89. *See* Railway Express Agency v. Super Scale Models, Ltd., 934 F.2d 135, 137 (7th Cir. 1991).
90. Wegman v. Dairylea Cooperative, 50 A.D.2d 108, 376 N.Y.S.2d 728, 736 (1975).
91. 622 F.2d 621 (2d Cir. 1980).
92. *Id.* at 622.
93. *Id.* at 624.
94. 934 F.2d 135 (7th Cir. 1991).
95. *Id.*
96. *Id.* at 136.
97. *Id.*
98. *Id.*
99. *Id.*

D. Fraud

In some states trademark owners can sue grey-market importers for fraud or misrepresentation.[100] In *Johnson & Johnson* (J&J),[101] J&J brought an action alleging that it was fraudulently induced to sell goods, based upon an oral misrepresentation that its products would be distributed only in Poland.[102] The products were subsequently distributed in the United States and sold at more competitive prices than those charged by J&J.[103] After finding that plaintiff would prevail on the fraud theory, the district court issued a preliminary injunction restraining the distribution of the grey-market goods.[104] The court of appeals, however, vacated the injunction after it concluded that the record did not actually support findings of fraud.[105]

Additionally, section 592 of the Tariff Act provides that any person who by fraud or negligence introduces, or attempts to introduce, merchandise into the commerce of the United States by means of any omission that is material, will be subject to a monetary penalty.[106] The merchandise may be seized, in certain circumstances, to ensure payment and may be forfeited if the penalty is not paid. Customs has invoked this civil fraud statute in cases involving U.S. and foreign individuals and companies that have negligently or intentionally provided false information concerning importation into the United States. A criminal fraud statute also provides for sanctions to those presenting false information to Customs' officers.[107]

E. Section 337 of the Tariff Act

Section 337 of the Tariff Act prohibits unfair methods of competition in the importation of articles into the United States.[108] *Duracell*[109] is the first grey-

100. *E.g.*, New York and New Jersey; *see* Hugh J. Turner, Jr., *Grey Market Litigation in the United States District Courts,* 11 N.C.J. Int'l L. & Com. Reg. 349, 363 (1986).

101. Johnson & Johnson Prods., Inc. v. DAL Int'l Trading Co., 798 F.2d 100 (3d Cir. 1986).

102. *Id.* at 101.

103. *Id.* at 102.

104. *Id.*

105. *Id.* at 106.

106. 19 U.S.C. § 1592(a) (1)(A)(ii) (1988).

107. *See* 18 U.S.C. § 542 (1988), providing a maximum of two years imprisonment for the importation, or attempted importation, of merchandise by fraudulent means.

108. Section 337 provides in part:

> Subject to paragraph (2), the following are unlawful, and when found by the Commission to exist shall be dealt with, in addition to any other provisions of law, as provided in this section.
>
> (a) Unfair methods of competition and unfair acts in the importation of articles . . . into the United States, or in the sale of such articles by the owner, importer, or consignee, the threat or effect of which is—(i) to destroy or substantially injure an industry in the United States; (ii) to prevent the establishment of such an industry; or (iii) to restrain or monopolize trade and commerce in the United States.

19 U.S.C.§ 1337(a) (1988).

109. Certain Alkaline Batteries, 49 Fed. Reg. 45,275 (1984); *see also* Michael Knoll, *Gray Market Imports: Causes, Consequences and Responses,* 18 L. & Pol'y Int'l Business 145, 213 (1986).

market case brought under section 337. The case involved a complaint by the maker of Duracell batteries aimed at enjoining the sale in the United States of batteries made by its Belgian subsidiary. The Belgian-made batteries were bought in Europe and sold in the United States at prices below those charged by Duracell in the United States. The ITC held that the grey-market Duracell batteries violated section 337.[110] President Reagan later rejected the ITC's determination, and the current effectiveness of section 337 is, therefore, uncertain.[111]

F. International Regimes

In *Yamaha*[112] plaintiff asserted that its rights were violated under the Paris Convention for the Protection of Industrial Property[113] (Paris Convention) and the Treaty of Friendship, Commerce and Navigation[114] (TFCN) between the United States and Japan. The court found that the plaintiff lacked standing to invoke the terms of either treaty that, by their terms, did not protect U.S. companies in the United States.[115]

Article 10 of the TFCN provides: "Nationals and companies of either Party shall be accorded, within the territories of the *other* Party, national treatment and most-favored-nation treatment with respect to . . . rights in trademarks, trade names, trade labels and industrial property of every kind."[116] Similarly, article 2(1) of the Paris Convention provides in part:

> Nationals of any country of the union shall, as regards to protection of industrial property, enjoy in all the countries of the Union the advantages that their respective laws . . . now grant . . . to nationals. Consequently, they *shall have the same protection as the latter,* and the same legal remedy against the infringement of their rights, provided the conditions and formalities imposed upon nationals are complied with.[117]

The treaties, therefore, are of no help to U.S. trademark owners that assert injury in the United States as a result of grey markets. However, as one commentator aptly recognized, section 526, whose protection is expressly limited to U.S. entities,[118] appears to violate the equal treatment language of the Paris Convention.[119] Surprisingly, section 526 has not yet been challenged on this ground, for such challenge might prevail based on the principle that, under U.S. law, international treaties supersede previously enacted federal statutes.

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110. Certain Alkaline Batteries, 49 Fed. Reg. 45,275; Knoll, *supra* note 109.
111. Knoll, *supra* note 109, at 214.
112. Yamaha Corp. of Am. v. United States, 745 F. Supp. 730, 732–33 (D.D.C. 1990).
113. Paris Convention for the Protection of Industrial Property, *ratified by United States* May 8, 1973, 21 U.S.T. 1583, 24 U.S.T. 2140 (hereinafter Paris Convention).
114. Treaty of Friendship, Commerce and Navigation, Apr. 2, 1953, U.S.-Japan, 4 U.S.T. 2063 [hereinafter TFCN].
115. *Yamaha,* 745 F. Supp. at 732.
116. TFCN, *supra* note 114, art. 10 (emphasis added).
117. Paris Convention, *supra* note 113, art. 2(1) (emphasis added).
118. *See* Polycast Tech. v. Uniroyal, 728 F. Supp. 926, 951 (S.D.N.Y. 1989).
119. Kaoru Takamatsu, *Parallel Importation of Trademark Goods: A Comparative Analysis,* 57 WASH. L. REV. 433, 438–39 (1982).

IV. Legislative Initiatives

The ever-growing volume of grey-market imports has produced several recent legislative efforts on both sides of the issue. Attesting to the powerful competing constituencies and high stakes involved, none has progressed beyond the committee stage.

A. In Support of Grey Markets

In May 1987, Sen. John Chafee (R-RI) introduced S. 1097, which would codify the Regulations. In 1989, Rep. Rod Chandler (R-WA) introduced H.R. 771, the Price Competitive Act of 1989,[120] which would go beyond the Supreme Court's ruling in *K Mart* by upholding the right of retailers to purchase grey-market merchandise. The House bill would have permitted importation of certain grey-market goods produced abroad both by companies subject to the common control of the U.S. trademark owner and by those authorized to use the trademark. Significantly, H.R. 771 would have clarified that the Lanham Act does not restrict the importation or sale of foreign-made articles bearing a genuine trademark.[121] The measure also was designed to eliminate a creative strategy employed by some manufacturers that have attempted to circumvent the Regulations by copyrighting their trademarks, labels, or packaging, and then suing independent importers for copyright infringement.[122] The Committee on Ways and Means did not adopt H.R. 771 either in whole or in part.[123] Indeed, neither S. 1097 nor H.R. 771 drew much attention, and no similar legislation has been proposed.

B. In Opposition to Grey Markets

During the last five years, Sen. Orin Hatch (R-UT) has introduced several similar bills that would prohibit grey-market imports.[124] Sen. Hatch explained that the legislation was intended to respond to the incorrect interpretation of the law by Customs and to problems not resolved by the Supreme Court in *K Mart*.[125] In addition, he asserted that the Supreme Court did not go far enough in requiring Customs to enforce section 526 to stop all grey-market imports.[126]

Sen. Hatch's most recent attempt to protect trademark owners is the Grey Market Legislation Act of 1991 (S. 894), which is based on its predecessor,

120. H.R. 771, 101st Cong., 1st Sess. (1989).
121. *See id.* sec. 2(f)(1).
122. *See id.*
123. *Bill (HR 771) Is Introduced to Protect Grey Market Imports*, 37 Pat. Trademark & Copyright J. (BNA) 327 (1989).
124. *See* S. 1671, 100th Cong., 1st Sess. (1987); S. 2903, 100th Cong., 2d Sess. (1988); S. 626, 101st Cong., 1st Sess. (1989); S. 894, 102d Cong., 1st Sess. (1991).
125. 135 Cong. Rec. S2866 (daily ed. Mar. 16, 1989).
126. *Id.*

S. 626.[127] The measure seeks to amend the Lanham Act by adding a new section 52 providing in part that "[n]o person may import into or sell within the United States any good that is manufactured outside the United States if that good, or the label, sign, print, package, wrapper, or receptacle, bears a trademark that is identical or confusingly similar[128] to a [U.S.] trademark . . . ."[129] The prohibition would apply regardless of whether the foreign manufacturer or trademark owner is related in any way to the owner of the U.S. trademark. The prohibition also would apply irrespective of whether the owner of the U.S. trademark owns, has registered, or has authorized the use of the trademark abroad.[130] Under this measure, any U.S. trademark owner or exclusive licensee of such owner would be allowed to bring a private action against an importer or seller of grey-market goods to enjoin other importations or sales of goods and to obtain monetary damages as well as lost profits occasioned by such sales.[131]

Significantly, the measure is not intended to prevent importation of goods that otherwise meet U.S. health and safety standards solely "because the goods [are] manufactured abroad and may be quite similar, though not identical, to goods sold in the United States by a U.S. trademark owner, provided that these imports do not bear the U.S. trademark owner's trademark."[132] Thus, the measure is correctly described as a "demarcation statute" as it simply requires the removal of the trademark; grey-market products still could be sold as generic, unmarked, or house brands.[133]

S. 894 was introduced on April 23, 1991, and the last action on the bill was taken on May 14, 1991, when it was referred to the Judiciary Committee. Conversations with committee staff indicate that due to pressures from competing interest groups and constituencies no further action is expected at this time.

V. Comparative Perspective

Whether U.S. grey-market law is more protective of authorized dealers than that of the United States' other major trading partners is an important issue in international economic relations as it is directly linked to charges of the existence of indirect trade barriers in the United States. More practically, a comparatively more protective U.S. grey-market system also might disadvantage U.S. consumers and other sectors. Proponents of grey markets, therefore, frequently assert

127. 137 CONG. REC. S4862 (daily ed. Apr. 23, 1991).
128. "Confusingly similar" did not exist in the previous bill (S.626).
129. 137 CONG. REC., *supra* note 127, at S4864-65.
130. *Id.* at S4865 (S. 894, § 52(b) (1)-(3)).
131. *Id.* (S. 894, § 52(d)).
132. *Id.* at S4864.
133. *Id.* In his speech, Sen. Hatch states that "[t]his is already an accepted form of importing such products." *Id.* As an example, he cites company Sears & Roebuck, which sells goods made by a U.S. trademark owner or an affiliate of a U.S. trademark owner under its own brand name or as a generic. *Id.*

that other key countries allow grey markets.[134] This conclusion, however, is a misleading oversimplification in most instances.

A. Japan

Neither the revised Trademark Law of Japan nor the Customs Duties Act of Japan expressly enjoins parallel importation of genuine goods.[135] The Osaka District Court decision in *N.MC. Co. v. Schulyro Trading Co.*,[136] which was affirmed by the Osaka High Court,[137] sets forth the major principles of Japanese grey-market law.

The case involved parallel imports of Parker pens from Hong Kong into Japan, which were competing with Parker pens sold by the Japanese authorized distributor. The court applied the criminal law theory of "substantive illegality" to the case, asserting that the territoriality principle of trademark law was irrelevant to grey markets.[138] The court examined several factors, including the quality of the grey-market pens, endorsed the view that grey markets promote competition in price and service, rejected the notion that parallel importers engage in "free riding," and found nothing substantively illegal in the case before it.[139]

A notice issued by the Customs Division of the Ministry of Finance of Japan subsequently provided that parallel imports may not be barred if the domestic trademark owner also holds the foreign trademark and is supplying the goods to the parallel importer, or where the domestic and foreign trademark owners properly should be deemed the same entity.[140] Additionally, the Japanese Free Trade Commission published guidelines stipulating that an attempt to impede parallel imports sold pursuant to a distribution agreement is an unfair business practice. Consequently, parallel imports of genuine goods cannot be enjoined by Japanese exclusive distributors under Japanese antitrust law.[141]

B. The European Economic Community

Articles 30 *et seq.* of the Treaty of Rome (Treaty) mandate the free movement of goods within the European Economic Community (EEC), and article 85 of the Treaty prohibits agreements likely to restrain trade between the EEC Member

134. *See, e.g., Legislation to Amend the Lanham Trademark Act Regarding Grey-Market Goods: Hearing on S.626 before the Subcomm. on Patents, Copyright and Trademarks of the Senate Comm. of the Judiciary,* 101st Cong., 2d Sess. 12, 26 (1990) (hereinafter *Hearing*).

135. Takamatsu, *supra* note 119, at 443.

136. 234 Hanta 57 (Osaka Dist. Ct.), *reprinted in* 16 Jap. Ann. Int'l L. 113 (1972); *see also* Takamatsu, *supra* note 119, at 443.

137. Takamatsu, *supra* note 119, at 443.

138. *Id.*

139. *Id.*

140. *Id.* at 443.

141. *Id.*

States. Exclusive distribution agreements violate EEC antitrust policy unless they fall within the purview of Regulation 1983/83[142] or the de minimis exemption.[143] Restrictions on parallel imports are not sanctioned by the exceptions to the EEC's rigorous policy against restraints of trade. In addition, the European Court of Justice (ECJ) repeatedly has held in favor of parallel imports involving genuine identical goods.[144]

For example, the ECJ upheld the European Commission's (Commission) decision *In re The Agreement of Ford-Werke AG,*[145] in which the Commission invalidated an arrangement whereby Ford AG acted expressly to limit parallel imports. Ford AG supplied vehicles to Ford Britain, a Ford subsidiary located in Britain, as well as to German distributors. Ford AG stopped supplying right-hand drive vehicles to German dealers because Ford Britain sold these vehicles at a higher price than did the German dealers. Thus, Ford Britain lost sales to the German dealers whose customers were purchasing the cars in Germany and bringing them back to Britain. The Commission found Ford's prevention of cross-border competition to be a detriment to the public interest and concluded that consumers were being deprived of the advantages of a common market.[146]

This and other similar cases demonstrate that allowing parallel imports and exports is rooted in one of the cardinal tenets of EEC policy: the promotion of the free flow of goods from one Member State to the other. The EEC is likely to continue allowing parallel imports of genuine identical goods between EEC Member States. Even in the intra-EEC context, however, results may be different if the grey-market goods differ markedly from the authorized ones.

In Britain, for example, courts apply the exhaustion doctrine, under which a trademark owner's rights are exhausted by affixing the trademark to the product. Therefore, British trademark owners generally cannot prevent importers from engaging in parallel imports.[147] However, plaintiffs in British cases have prevailed under passing-off and misrepresentation theories when the differences in quality between the grey-market goods and authorized products have been significant, and there has been no clear product differentiation by the importer.[148]

The passing-off doctrine also has been applied in Germany. When a Belgian entity allegedly imported inferior coffee into Germany under the same trademark owned by a German company, the import was deemed violative of German

142. Commission Regulation 1983/83, 1983 O.J. (L 173) 1; 2 Common Mkt. Rep. (CCH) ¶ 2730.

143. *Commission Notice of September 3, 1986 Concerning Agreements of Minor Importance Which Do Not Fall Under Article 85(1) of the Treaty Establishing the European Economic Community,* 1986 O.J. (C 231) 2; 2 Common. Mkt. Rep. (CCH) ¶ 2700.

144. Takamatsu, *supra* note 119, at 447–52.

145. Commission Decision 82/628, 1982 O.J. (L 256) 20; 3 C.M.L.R. 267 (1982).

146. *Id.*

147. *See* Lawrence J. Cohen, *Trademarks and Protection Against Parallel Imports,* 10 EUR. INTELL. PROP. REV. 369 (1990).

148. *Id.* at 370.

unfair competition law.[149] In an earlier case, however, a German court allowed parallel imports, holding that German consumers understood that the parallel imports had an origin different from the German goods.[150]

The passing-off doctrine is of particular interest because its validity has not been successfully challenged even in situations where the parallel imports originated from EEC Member States. Thus, notwithstanding EEC antitrust doctrine and the principle of free movement of goods, a parallel import from EEC countries that is passed off as the authorized product might be enjoined.[151]

C. CANADA

The Supreme Court of Canada confronted parallel imports in *Consumers Distributing Company Ltd. v. Seiko Time Canada Ltd.*,[152] in which an authorized Canadian Seiko distributor sued a Canadian company that marketed in Canada Seiko products obtained abroad. The lower court agreed that defendant had engaged in some form of misrepresentation. Although defendant did sell authentic Seiko watches, defendant did not provide the services associated with Seiko authorized points of sale and distribution channels. The Supreme Court of Canada disagreed, noting that once defendant complied with the interlocutory injunction requiring it to notify its customers that it was not an authorized dealer, there would be no misrepresentation. Second, it found that the relevant product was the watch alone and not the ancillary product services. The court noted: "If one were to raise the point of sale service to the level of being an element of a product, then a quasi-monopolistic protection under the doctrine of passing-off would arise in one who adopts any merchandising style . . . which had . . . not been adopted . . . by a competitor when selling a brand name product."[153] This decision clearly facilitates parallel imports into Canada. However, it must be stressed that the parties did not raise the possibility of trademark infringement. The results could have been different if such a possibility had been adjudicated by the court or if the grey-market goods had been materially different from the original ones.

VI. Policy Considerations

The arguments advanced by proponents and opponents of grey markets have been elucidated in detail in congressional hearings[154] and debates. While the scope

149. *See* Re Hag Coffee, 3 C.M.L.R. 154 (Ct. App.—Hamburg) (1989).
150. *See* Takamatsu, *supra* note 119, at 445.
151. *See* Cohen, *supra* note 147, at 370.
152. 1 S.C.R. 583 (1984).
153. *Id.* at 602.
154. *See, e.g., Hearing, supra* note 134, at 843; 137 CONG. REC., *supra* note 127, at S4863; 135 CONG. REC., *supra* note 125, at S2866-67.

of this article does not permit a detailed analysis of the merits and demerits of all arguments, some discussion of the major issues is imperative as the ultimate disposition of the grey-market problem must rest on the legal rights, constraints, and policy objectives surrounding the grey-market debate. The arguments generally revolve around the following issues.

A. Consumer Deception and Injury

Opponents contend that grey markets violate established intellectual property principles by undermining a fundamental tenet of trademark jurisprudence: the prevention of consumer deception and confusion. Parallel imports and authorized goods carry identical trademarks. Consumers, therefore, cannot distinguish between the two. Since parallel imports frequently are not of the same quality and composition as the original goods and often lack warranty policies, consumers do not get that for which they bargain. Moreover, because parallel imports may fail to meet critical quality, health, and safety regulations, consumers are forced to assume risks of which they are not even aware. Proponents argue that product differences are minimal, and that consumers are aware of the differences in the rare cases in which meaningful differences do exist.

B. Trademark Owners' Rights

Opponents claim that the property and contractual rights in the trademark bargained for by the trademark owner are being violated. Therefore, allowing parallel imports amounts to an arbitrary taking of property rights as well as interference with contract. And since the inviolability of property and contractual rights is fundamental to a free market, parallel imports are inherently anticompetitive and unfair. Proponents retort with the exhaustion doctrine and claim that trademark owners can protect themselves by negotiating with the original manufacturers of the goods and policing the distribution channels for the products.

C. Macroeconomic Effect

Opponents argue that parallel importers drive domestic manufacturers out of business with all the ensuing macroeconomic losses including loss of jobs and spending power. Proponents assert that there is no competition with domestic manufacturers as parallel imports usually are manufactured abroad in the same plants as the products sold by the authorized distributors. The only U.S. jobs at stake are those of importers and sellers of authorized imports versus the importers and sellers of parallel imports. Such losses, if any, proponents argue, are drastically offset by the benefits of parallel imports such as price competition and increased supply.

D. COUNTERFEITING

Parallel imports, opponents assert, encourage and facilitate counterfeiting. This is so because parallel importers profit from the reputation and goodwill of the original goods. Proponents respond that, since parallel imports are genuine goods, counterfeiting is not an issue.

E. "FREE RIDING" VERSUS "PRICE DISCRIMINATION"

The most pervasive economic castigation of parallel imports is that they deprive authorized licensees of a fair return on their investment by encouraging "free riding." The argument is that parallel importers are able to sell their goods only because of the authorized distributors' substantial investment in goodwill and customer service for the goods. Even worse, the expected consumer dissatisfaction generated by the lower quality parallel imports is projected onto the authorized goods. Authorized distributors quickly realize that their investments benefit the competition at least as much as, if not more than, themselves, thereby reducing the incentive to invest in the promotion of goodwill by advertising and offering customer satisfaction and warranty services. The result is less market information about products, quality assurance services and controls, decreasing competition and, ultimately, fewer products.

Proponents respond that parallel imports provide the only real price competition for a variety of goods. For, in order to sustain higher prices, foreign manufacturers restrict distribution to higher priced retailers and boutiques. Since parallel importers sell through discount stores, consumer outlets, and catalogues, they increase product availability and price competition.

Proponents, moreover, fundamentally reject the free-riding argument, asserting that grey markets arise when foreign entities perceive that the U.S. market will bear higher prices and, consequently, implement different, or dual, pricing systems for the U.S. market. Parallel importers are able to capitalize on price differentials by purchasing the items abroad at a lower price and selling them at a higher price in the United States. However, even after ancillary costs, such as shipping and custom duties, parallel importers are able to sell at prices significantly below those offered by the authorized distributors. Hence, the cumulative effect of parallel imports, proponents assert, is to ensure price competition for many products.

Opponents find no evidence that parallel importers willingly pass along a portion of their profits to U.S. consumers. On the contrary, parallel importers usually charge as much as the market will bear and many parallel imports sell at or above the prices charged for the authorized products. Proponents' claims of price savings are based on their comparisons of discount store prices and full price retailers. Thus, claim opponents, proponents' claims "would evaporate, if

they would compare apples and apples, that is the discounted price of legitimate goods with the discounted price of grey market goods."[155]

VII. Conclusion

Notwithstanding the strong assertions of grey-market proponents to the contrary, the dual price theory of parallel imports neither withstands business analysis nor is it supported by empirical evidence.

There are several compelling reasons for why price discrimination is not a salient cause of parallel imports. The first is that price discrimination is only possible in circumstances where a seller possesses substantial, almost monopolous, market power, and the price elasticity of demand for the product is lower in the market where the parallel importer charges higher prices.[156] These conditions, however, do not apply to the most popular targets of grey-market importation, such as consumer electronics, cameras, batteries, cosmetics, and watches. Sales of such products uniformly involve numerous points of sale, low concentration of market share, and vigorous product as well as inter-brand competition. Certainly, U.S. demand for those products is not systemically less price elastic than in Western Europe, Japan, and other relevant markets.[157] Indeed, if price discrimination were the reason for grey markets, parallel imports would only be brought into high-price markets such as the United States, but not into other countries, such as Brazil and Korea. Instead, parallel imports are a ubiquitous international phenomenon. One must, therefore, look to the cost—not price—differentials affecting parallel importers and authorized dealers in order to elucidate the incentives for grey markets.

Manufacturers generally prefer distributing their products through exclusive national distributors. By conferring exclusive distribution rights, manufacturers can extract a higher level of commitment, both in terms of minimum purchase requirements and product promotion and service, than in sales to nonexclusive distributors. Dealing with exclusive distributors also minimizes manufacturers' transaction costs. It is not surprising then that manufacturers rarely sell directly to parallel importers. Doing so would not only violate the letter and spirit of their exclusive distribution arrangements, but also would not make economic sense.

Since parallel importers cannot obtain goods directly from manufacturers, they must purchase the items from foreign wholesalers instead, and, obviously, at higher prices than those paid by the wholesalers to the manufacturers. Authorized distributors, by contrast, do not incur this markup in purchasing directly from manufacturers.[158] Parallel importers generally only will have an incentive to compete with authorized distributors if their higher purchase costs and other

155. *Hearing, supra* note 134, at 145.
156. *Id.* at 176.
157. *Id.* at 176–77.
158. *Id.* at 163.

expenses are lower than the costs incurred by authorized distributors. In other words, parallel importing will be profitable only if the value added costs of authorized distributors are greater than the shipping cost of the parallel imports to the United States and related transaction costs. This is so because other costs equally borne by parallel importers and authorized distributors, such as labor and insurance, will usually be higher for the U.S entity. A substantial expense incurred by the authorized dealer that is spared to the parallel importer is the creation of goodwill: advertising, promotions, special discount programs, market testing and research, warranty services, customer service centers, and legal fees for protecting the trademark. Indeed, that parallel importers do not bear such goodwill expenses explains why grey markets occur even when prices in the target country are no higher, and sometimes even lower, than prices in the country of origin.[159] The "free riding" explanation is, therefore, persuasive, and trademark owners legitimately argue that they are deprived of returns on their investment by parallel imports.

At the same time, however, the foreign trademark reflects an endorsement of that product by the manufacturer in that country, and any purchaser of the product—whether an end user or a parallel importer purchasing the product for resale—is entitled to have the product recognized as such. Demarcation statutes, such as S. 894 (Grey Market Legislation Act of 1991), obliterate any reference to the product being manufactured under the aegis of a reputable foreign manufacturer, thereby ignoring that the parallel imports bear genuine marks and depriving the owner of the mark of the international or foreign goodwill associated with the product. Moreover, there is nothing intrinsically wrong in having similar products with different attributes on the market. As long as these differences are fully disclosed, the consumer should be able to decide whether there is a market for the parallel import.

Customs' regulations and the case law are divorced from the real economic dynamics of grey markets and fail to satisfy what should be the key goals of grey-market regulation: protecting domestic trademark owners from free-riding without depriving bona fide purchasers or licensees of foreign marks or products of their right to benefit from the goodwill of the foreign mark even while protecting consumers, by ensuring they get that for which they pay and promoting price competition and market transparency.

The Regulations, even after *K Mart,* do not respond to the free-riding problem or the foreign trademark owners' rights to profit from the goodwill of the foreign trademark. The Lanham Act cases focusing on product differences, by contrast, are a step in the right direction. However, as was shown earlier, the cases provide no guidance on whether the Lanham Act inquiry must take into account the manufacturer's intent to distribute in a certain territory or inquire solely into the difference between products. As to the latter, it is necessary to clarify whether the

159. *See id.* at 165.

test is one of material or physical differences between products and, if the former, whether materiality is a qualitative criterion based on a court's estimate of consumer preferences in the United States or the country of origin.

The solution to grey markets is not demarcation but disclosure. Customs, with congressional support, should adopt rigorous disclosure and labelling standards whereby parallel importers would have to disclose prominently their products' country-of-origin and state that the products are different from the products distributed by authorized entities. Government agencies might consider developing categories of different product characteristics for various product groups which would have to be disclosed by parallel importers, thereby obviating the need to correct current uncertainties in the courts' materiality standard. Disclosure would protect consumers and increase market information and price competition. Parallel importers would still enjoy the benefits associated with the foreign trademark, while authorized products would be distinguished from parallel imports, thereby preserving the authorized product's domestic goodwill. Disclosure would also be a less anticompetitive solution than the proposed demarcation statutes and be consistent with the passing-off categories found in other industrialized countries. While disclosure does not provide a perfect solution, it constitutes a lesser evil in an area where Nirvana does not exist.