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## The Gray Market Case: Trademark Rights v. Consumer Interests

The term "gray market" refers to the importation and sale of foreign goods in the United States by parties outside the manufacturer's authorized channel of distribution. In a typical fact pattern,<sup>1</sup> a third party lawfully purchases genuine trademarked goods abroad. The goods are then imported into the United States without the consent of the domestic trademark owner, an exclusive distributor frequently owned or controlled by the manufacturer. An unauthorized distributor then sells these gray market goods or parallel imports to consumers, generally at prices considerably less than those charged by the authorized distributor.<sup>2</sup>

This market, accounting for perhaps \$10 billion per year in imports,<sup>3</sup> has expanded dramatically in the past five years.<sup>4</sup> As a result, the long simmering conflict between trademark owners and parallel importers has reached the boiling point. Trademark owners, contending that parallel importers mislead consumers and unfairly "free ride" on the trademark owner's goodwill, advocate prohibition of gray market imports under section 526 of the Tariff Act of 1930.<sup>5</sup> Section 526 bars importation of foreign goods bear-

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1 The variations in the gray market are myriad. The same company, related companies, or wholly separate companies may own the domestic and foreign trademark rights. The goods of the trademark owner may be identical to, or different from, the parallel import. Goods may be produced in the United States by the domestic trademark owner and different or identical goods may be produced abroad by the United States owner or its affiliates. Services and warranties may or may not be the same here and abroad. For a discussion of various permutations in the gray market, see Takamatsu, *Parallel Importation of Trademarked Goods: A Comparative Analysis*, 5 WASH. L. REV. 433 (1982).

2 "A gray market is created when an arbitrageur takes advantage of a price difference between two markets by buying in the market where prices are lower and selling in the market where prices are higher." W. Goebel *Porzellanfabrik v. Action Indus.*, 589 F. Supp. 763, 764 n.1 (S.D.N.Y. 1984).

3 See Riley, "Gray Market" *Fight Isn't Black and White*, Nat'l L.J., Oct. 28, 1985, at 1, col. 4 (gray market estimated at \$10 billion per year). But market estimates vary. See, e.g., Critser, *Trade War Erupts in Gray-Market Goods, INC.*, March 1986, at 19 (gray market estimated at \$7 billion in 1985).

4 The rapid escalation in parallel importation during the past five years resulted primarily from the dramatic rise in the United States dollar relative to foreign currencies. As the dollar rose, the profitability of gray market imports increased. The rise in the dollar, however, did not cause the gray market; it simply made what was already profitable more profitable. See note 108 *infra* and accompanying text. See generally Lexecon, Inc., *The Economics of Gray-Market Imports* (May 1985) (unpublished manuscript) (available in the files of the Notre Dame Law Review).

5 Tariff Act of 1930, Pub. L. No. 361, 46 Stat. 590, 741 (codified at 19 U.S.C. § 1526(a) (1982)), states:

[I]t 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

ing a registered United States trademark without the domestic trademark owner's consent, provided that an American citizen, corporation, or association owns the trademark and that it has been recorded with the United States Customs Service.

In response, parallel importers argue that the gray market promotes competition, maintains low prices, and protects consumer interests. The gray marketeers advocate continued parallel importation under current customs regulations,<sup>6</sup> which purport to interpret section 526.<sup>7</sup> These regulations deny the protections of section 526 in two instances: (1) when the foreign and domestic trademark owners are owned by the same person or entity or are parent and subsidiary companies or otherwise subject to common ownership or control; or (2) when the foreign goods bear a trademark applied under the authorization of the domestic trademark owner.

In three recent cases, United States trademark owners challenged the customs regulations as invalid interpretations of section 526 because they deny the protections of the statute to trademark owners affiliated with foreign manufacturers.<sup>8</sup> The courts upheld the regulations, thereby allowing gray market importation to continue. These decisions demonstrated judicial reluctance to eliminate all gray market importation, but failed to adequately recognize accepted principles of trademark protection. The courts have yet

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receptacle, bears a trademark owned 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 . . . and if a copy of the certificate of registration of such trademark is filed with the Secretary of the Treasury . . . unless written consent of the owner of such trademark is produced at the time of making entry.

6 19 C.F.R. § 133.21 (1985) states that:

(b) *Identical trademark.* Foreign-made articles bearing a trademark identical with the one owned and recorded by a citizen of the United States or a corporation or association created or organized within the United States are subject to seizure and forfeiture as prohibited importations.

(c) *Restrictions not applicable.* The restrictions set forth [above] do not apply to imported articles when: (1) Both the foreign and the United States 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 otherwise subject to common ownership and control . . . ; (3) The articles of foreign manufacture bear a recorded trademark or trade name applied under authorization of the United States owner.

7 The United States Customs Service, a branch of the Department of the Treasury, is charged with the administration of § 526 of the Tariff Act of 1930 (19 U.S.C. § 1526 (1982)) and § 42 of the Lanham Trade-mark Act of 1946 (15 U.S.C. § 1124 (1982)).

8 See *Olympus Corp. v. United States*, 627 F. Supp. 911 (E.D.N.Y. 1985), *appeal docketed*, No. 85-6282 (2d Cir. Sept. 27, 1985); *Coalition to Preserve the Integrity of Am. Trademarks v. United States*, 598 F. Supp. 844 (D.D.C. 1984), *appeal docketed*, No. 84-5890 (D.C. Cir. Dec. 28, 1984) (argued Jan. 22, 1986) [hereinafter cited as *COPIAT*]; *Vivitar Corp. v. United States*, 593 F. Supp. 420 (Ct. Int'l Trade 1984), *aff'd on other grounds*, 761 F.2d 1552 (Fed. Cir. 1985), *cert. denied*, 106 S. Ct. 791 (1986).

to reconcile the conflicting goals of protecting the rights of trademark owners and guarding the interests of consumers.

This note examines the conflict between trademark rights and consumerism. Part I briefly traces the historical background of the controversy. Part II argues that the customs regulations are an invalid interpretation of section 526. Part III discusses whether enforcement of section 526 adequately serves the policies underlying protection of trademark rights and consumer interests. Part IV considers several alternative solutions to the conflict, concluding that parallel importation should continue, provided that Congress establishes greater protection of both trademark rights and consumer interests.

### I. The History of the Gray Market Conflict

The conflict between section 526 and the customs regulations stems from the 1921 decision of the United States Court of Appeals for the Second Circuit in *A. Bourjois & Co. v. Katzel*.<sup>9</sup> This case involved an American retailer who imported genuine trademarked goods without the consent of the United States trademark owner. The trademark owner purchased the trademark rights from the French manufacturer and invested significant sums in acquiring those rights and in developing the domestic market. The district court enjoined such importation, but the Second Circuit reversed. The Second Circuit explained that, because the goods were genuine, no consumer deception or confusion and therefore no trademark infringement existed.<sup>10</sup> This holding followed the universality theory of trademarks: a trademark legitimately applied to goods anywhere in the world does not infringe an identical trademark registered in the United States by the exclusive distributor.<sup>11</sup>

In response to the inequities<sup>12</sup> it perceived in *Katzel*, Congress quickly enacted section 526 as an amendment to the Tariff Act of 1922, then under consideration by Congress.<sup>13</sup> Shortly after enact-

9 275 F. 539 (2d Cir. 1921).

10 *Id.* at 543. Justice Hough, dissenting, argued that trademark laws protect the business of the trademark owner from unfair competition, that the majority did not properly consider the unfair appropriation of goodwill embodied in the United States trademark, and that the genuineness of the goods should not be controlling as to the trademark infringement issue. *Id.* (Hough, J., dissenting).

11 The Second Circuit had previously established, through a series of cases, the universality theory of trademarks by denying protection to United States trademark owners against trademarks legitimately applied to goods elsewhere in the world. *See, e.g.*, *Fred Gretsch Mfg. Co. v. Schoening*, 238 F. 780 (2d Cir. 1916); *Apollinaris Co. v. Scherer*, 27 F. 18 (C.C.S.D.N.Y. 1886). These decisions controlled the Second Circuit holding in *Katzel*.

12 *See* notes 102-11 *infra* and accompanying text.

13 42 Stat. 858, 975. At the time Congress considered enactment of § 526, the Supreme Court had already granted certiorari in *Katzel*. *See A. Bourjois & Co. v. Katzel*, 257

ment of section 526, the Supreme Court reversed *Katzel* and found actionable trademark infringement.<sup>14</sup> A unanimous Court noted that the true significance of the mark was not to indicate the origin or manufacturer of the goods, but rather to signify the local business goodwill of the domestic owner of the mark.<sup>15</sup> Congress, in enacting section 526, and the Supreme Court in *Katzel*, thus adopted the territoriality theory of trademarks as applied to genuine goods: a trademark has a separate legal existence under each country's laws and its proper function is to symbolize the domestic goodwill of the domestic mark holder.<sup>16</sup>

Section 526 remains unchanged today in relevant part despite congressional consideration on several different occasions.<sup>17</sup> The

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U.S. 630 (1921). Apparently Congress was anxious to move more quickly. Section 526 was proposed as a floor amendment to the Tariff Act. The Senate debated the Act briefly and amended it once during the debate. Congress then amended again in joint conference. Because of the haste to enact corrective legislation, the debate was unfocused and misinformed. See notes 49-50 *infra* and accompanying text.

14 260 U.S. 689 (1923).

15 *Id.* at 691-92. Justice Holmes indicated that Bourjois had control and ownership of the mark and had made considerable investments in the mark itself, in advertising, and in quality control. *Id.* at 690-91. Due to Bourjois' efforts and expenditures, the Court said that the public understood the trademark in the United States to signify that the goods came from Bourjois and not from the foreign manufacturer. *Id.* at 692. The Court did not make reference to § 526 in its opinion.

16 Several Supreme Court opinions reflect the territoriality of trademark rights. These opinions ground the doctrine in the independent sovereignty of nations. See, e.g., *Osawa & Co. v. B & H Photo*, 589 F. Supp. 1163, 1172 (S.D.N.Y. 1984) (citing cases). For an excellent discussion of the territoriality doctrine, see *id.* at 1171-74. See also *Weil Ceramics and Glass, Inc. v. Dash*, 618 F. Supp. 700, 705-06 (D.N.J. 1985); *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 548 F. Supp. 1063, 1066 (E.D.N.Y. 1982), *vacated*, 719 F.2d 42 (2d Cir. 1983); *Derenberg, Territorial Scope and Situs of Trademarks and Good Will*, 47 VA. L. REV. 733, 736-37, 750 (1961) (establishment by domestic markholder of local goodwill justifies trademark protection against gray market imports); *Derenberg, Current Trademark Problems in Foreign Travel and the Import Trade*, 49 TRADEMARK REP. 674, 690-96 (1958) (trademarks are territorially independent and may be separately controlled and owned in different countries by different persons); Note, *Discrimination Against Foreign Owners of U.S. Trademarks Under 19 U.S.C. § 1526*, 18 GEO. WASH. J. INT'L L. & ECON. 423, 435-40 (1984) (United States has undertaken obligations through the Pan-American Convention and the Paris Convention to accord to nationals of other signatories the same trademark rights accorded to United States nationals). But see *Callman, Worldmarks and Antitrust Law*, 11 VAND. L. REV. 515, 518-19 (1958) (goodwill associated with a worldmark can only have one situs and that situs is where the goods are manufactured). *A. Bourjois & Co. v. Aldridge*, 263 U.S. 675 (1923), provides additional support for the territoriality approach. In a similar action arising under § 27 of the Trade-Mark Act of 1905 (predecessor to § 42 of the Lanham Trade-Mark Act), the *Aldridge* Court held that Customs must exclude from entry genuine goods bearing a registered trademark. *Id.* at 676.

17 In 1930, Congress repealed the Tariff Act of 1922 and enacted the Tariff Act of 1930 without changing § 526. See 46 Stat. 590, 741. In 1944, the bill which ultimately became the Lanham Trade-Mark Act of 1946 would have merged § 526 of the Tariff Act into § 27 of the Trade-Mark Act of 1905 (currently § 42 of the Lanham Act). Testimony at the hearing by an Antitrust Division witness criticized the bill as allowing exclusion of goods in ways the Antitrust Division thought anti-competitive. See *Hearings on H.R. 82 Before A Subcomm. of the Senate Comm. on Patents*, 78th Cong., 2d Sess. 57, 68 (1944). As a result, § 526 remained

customs regulations have a more erratic history. The initial regulations, adopted in 1923<sup>18</sup> and in 1931,<sup>19</sup> were fully consistent with the statute. In 1936, Customs amended its regulations, without explanation, by adding the provision that Customs would not bar a genuine foreign trademarked good from importation if "the same person or entity" owned the foreign and domestic marks.<sup>20</sup> In 1953, Customs once again amended its regulations without explanation, expanding the "same person or entity" exemption to include "related companies,"<sup>21</sup> but then retreated in 1959 back to the 1936 regulations.<sup>22</sup> As a result of these frequent changes, Customs inconsistently enforced its own regulations.<sup>23</sup>

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unchanged and Congress enacted the Lanham Act without merging § 526 into § 42 of the Act.

In 1954, Congress was presented with a bill which would have made § 526 inapplicable when the U.S. trademark owner was affiliated in any way with the foreign manufacturer. *See* H.R. 9476, 83d Cong., 2d Sess. (1954). This bill would have merged the customs regulations into § 526. That portion of the bill, however, was removed by unanimous consent during the House hearings with the concurrence of the Treasury Department. *See Hearings on H.R. 9476 Before the House Comm. on Ways & Means*, 83d Cong., 2d Sess. 9 (1954).

In 1959, the administration-sponsored Celler Bill was introduced to repeal § 526, but no hearings were held and the bill was never reported out of committee. *See* H.R. 7234, 86th Cong., 1st Sess. (1959). The bill was highly controversial and hotly debated, pitting trademark property rights against antitrust concerns. *See generally* Bicks, *Antitrust and Trademark Protection Concepts in the Import Field*, 49 TRADEMARK REP. 1255 (1959); Vandenburg, *The Problem of Importation of Genuinely Marked Goods is Not a Trademark Problem*, 49 TRADEMARK REP. 707 (1959); Derenberg, *Current Trademark Problems in Foreign Travel and the Import Trade*, 49 TRADEMARK REP. 674 (1959); Atwood, *Import Restrictions on Trademarked Merchandise—The Role of the United States Bureau of Customs*, 59 TRADEMARK REP. 301 (1969).

In 1978, Congress amended § 526 (and § 42 of the Lanham Act) by creating an exception for goods imported for personal use or consumption. *See* 19 U.S.C. § 1526(d) (1982). Congress did not, in any way, amend § 526(a).

18 *See* Customs Regulations of 1923, art. 476 (superseded 1931).

19 *See* Customs Regulations of 1931, art. 518(a) (superseded 1936).

20 *See* T.D. 48,537, 70 Treas. Dec. 336 (1936) (superseded 1953). The regulations, which previously dealt solely with § 526, were amended to encompass only § 27 of the Trade-Mark Act of 1905. The Tariff Commission (predecessor to the International Trade Commission) noted in 1944 that genuine goods were properly barred from importation under § 526 when the U.S. and foreign marks were owned by the same person, since the customs regulations promulgated in 1936 did not apply to § 526. *See Hearings on H.R. 82 Before A Subcomm. of the Senate Comm. on Patents*, 78th Cong., 2d Sess. 57, 86-87 (1944).

21 *See* T.D. 53,399, 88 Treas. Dec. 383-84 (1953) (superseded 1959). Customs amended the regulations to expand the "same person or entity" ownership requirement to also include those situations where marks were owned by companies that were "related" within the meaning of § 45 of the Lanham Act. Once again, Customs provided no explanation for the changes in the regulations.

22 *See* T.D. 54,932, 94 Treas. Dec. 433-34 (1959) (superseded 1972).

23 *See* note 17 *supra* (1944 enforcement); notes 25 (1957 enforcement) and 72 *infra* and accompanying text. *See also* Note, *The Greying of American Trademarks: The Genuine Goods Exclusion Act and the Incongruity of Customs Regulation C.F.R. § 133.21*, 54 FORDHAM L. REV. 83, 98-101 (1985).

One commentator has suggested that Customs often excluded goods in spite of the regulations because of lack of information stemming from prior inconsistent reporting requirements. *See* Atwood, *supra* note 17, at 307. Customs thus may not have been aware of all facts relating to the relationship between the trademark owners and the foreign manu-

In 1972, Customs promulgated the current regulations,<sup>24</sup> adopting the antitrust doctrines set forth in *United States v. Guerlain, Inc.*<sup>25</sup> These consolidated "perfume cases" held that the American part of a single international enterprise could not properly bar genuine imports under section 526. The district court held that such use of section 526 by an exclusive distributor constituted monopolization of the market for its trademarked goods in violation of section 2 of the Sherman Act.<sup>26</sup> However, both the courts<sup>27</sup> and the Antitrust Division of the Department of Justice<sup>28</sup> have since rejected the antitrust theories of *Guerlain*. The Customs Service now argues that the 1972 regulations are valid upon other grounds.<sup>29</sup>

Because of the substantial increase in gray market imports in the early 1980s,<sup>30</sup> trademark owners attempted to convince Customs to modify its regulations.<sup>31</sup> Impatient with subsequent delays

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facturers. See also *Vivitar Corp. v. United States*, 593 F. Supp. 420, 432 (Ct. Int'l Trade 1984); Brief for 47th Street Photo, Inc. at 50 n.16, *COPIAT*, No. 84-5890 (D.C. Cir. Dec. 28, 1984).

24 See 19 C.F.R. § 133.21(b), (c)(1)-(3) (1985) (relevant text at note 6 *supra*).

25 155 F. Supp. 77 (S.D.N.Y. 1957), *vacated and remanded*, 358 U.S. 915 (1958), *dismissed with prejudice*, 172 F. Supp. 107 (S.D.N.Y. 1958). This case involved consolidation of three antitrust actions against perfume distributors. These exclusive distributors were domestic trademark owners affiliated with foreign manufacturers. The stimulus for the action was Customs' use of § 526 to bar the importation of gray market goods. Customs authorities deemed themselves legally required to exclude parallel exports.

Customs provided no explanation for the 1972 regulations in either the notice proposing (35 Fed. Reg. 19,269 (1970)) or adopting (37 Fed. Reg. 20,677 (1972)) the new regulations. The Secretary of the Treasury, however, has maintained until very recently that the 1972 regulations were based upon *Guerlain*. See W. Allen, *International Licensing—The Potential Domestic Consequences* 29 (Feb. 1986) (unpublished paper presented to Am. Intell. Prop. Ass'n) (available in the files of the Notre Dame Law Review).

26 See *Guerlain*, 155 F. Supp. at 87. But see notes 56-68 *infra* and accompanying text. Section 2 of the Sherman Act, 15 U.S.C. § 2 (1982), provides: "Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony . . ."

27 See note 62 *infra* and accompanying text.

28 See text accompanying note 64 *infra* (quoting Brief for the United States as Amicus Curiae at 15 n.12, *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 719 F.2d 42 (2d Cir. 1983) [hereinafter cited as *Amicus Brief*]).

In rebuttal, the Civil Division of the Justice Department (representing the Treasury Department and the Customs Service in civil litigation) claimed that the views of the Antitrust Division are "not binding on the government and should be treated as simply expressing another viewpoint." Brief for 47th Street Photo, Inc., *supra* note 23, at 52-53 (citing the Justice Department brief in the Court of International Trade in *Vivitar*, 593 F. Supp. 420).

29 See text accompanying notes 42-55 and 69-94 *infra*.

30 See *Riley*, *supra* note 3, at 1, col. 3-4.

31 In April 1982, *Vivitar Corp.* urged Customs to rescind the regulations as contrary to the plain language of § 526. Customs drafted a notice of proposed rulemaking to that effect, but the initiative was stalled by special interest groups lobbying for continued gray market importation. See *Victor, Preventing Importation of Products in Violation of Property Rights*, 53 ANTITRUST L.J. 783, 798 (1984).

in governmental policy studies,<sup>32</sup> the trademark owners turned to private litigation.<sup>33</sup> In three recent cases, trademark owners have directly challenged the validity of the customs regulations.<sup>34</sup> The central issue in each case was whether the customs regulations, by limiting the scope of section 526, are consistent with that statute. All three courts sustained the validity of the regulations.<sup>35</sup>

In *Vivitar Corp. v. United States*,<sup>36</sup> the only appellate decision, the Court of Appeals for the Federal Circuit found that the regulations do not properly interpret section 526 and are not controlling with respect to the scope of the statute.<sup>37</sup> Nevertheless, the court characterized the regulations as no more than a definition of Customs' role in its administration of the statute.<sup>38</sup> Thus, the court upheld the regulations as "a reasonable exercise of administratively initiated enforcement,"<sup>39</sup> a theory neither briefed nor argued by the parties.<sup>40</sup> Rather than having Customs enforce trademark rights at the border, the court suggested that United States trademark owners should adjudicate their rights in federal district court. If successful, the trademark owner would then be "entitled to have the parallel imports excluded by Customs."<sup>41</sup>

32 In 1983, the Cabinet Council on Commerce and Trade (now part of the Economic Policy Council) directed its Working Group on Intellectual Property (WGIP) to study the issue of gray market importation and prepare a recommendation for the President. *Id.* Perceiving the need for more information on the economic effects of parallel imports, the WGIP requested additional economic data in May 1984. See 49 Fed. Reg. 21,453 (1984). The WGIP has not yet made its recommendations.

33 See, e.g., *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 719 F.2d 42 (2d Cir. 1983), *vacating* 548 F. Supp. 1063 (E.D.N.Y. 1982); *Model Rectifier Corp. v. Takachiho Int'l*, 709 F.2d 1517, 221 U.S.P.Q. (BNA) 502 (9th Cir. 1983); *Weil Ceramics & Glass, Inc. v. Dash*, 618 F. Supp. 700 (D.N.J. 1985); *Selchow & Righter Co. v. Goldex Corp.*, 612 F. Supp. 19 (S.D. Fla. 1985); *El Greco Leather Prods. Co. v. Shoe World, Inc.*, 599 F. Supp. 1380 (E.D.N.Y. 1984); *Osawa & Co. v. B & H Photo*, 589 F. Supp. 1163 (S.D.N.Y. 1984); *In re Certain Alkaline Batteries*, Inv. No. 337-TA-165, *reported at* [July-Dec] INT'L TRADE REP. (BNA) No. 1, at 767 (Dec. 19, 1984), *disapproved by President, reported at* 50 Fed. Reg. 1,655 (1985), *appeal dismissed sub nom. Duracell, Inc. v. United States ITC*, 778 F.2d 1578 (Fed. Cir. 1985); *Parfums Stern, Inc. v. United States Customs Serv.*, 575 F. Supp. 416 (S.D. Fla. 1983).

34 See *Olympus Corp. v. United States*, 627 F. Supp. 911 (E.D.N.Y. 1985), *appeal docketed*, No. 85-6282 (2d Cir. Sept. 27, 1985); *COPIAT v. United States*, 598 F. Supp. 844 (D.D.C. 1984), *appeal docketed* No. 84-5890 (D.C. Cir. Dec. 28, 1984) (argued Jan. 22, 1986); *Vivitar Corp. v. United States*, 593 F. Supp. 420 (Ct. Int'l Trade 1984), *aff'd on other grounds*, 761 F.2d 1552 (Fed. Cir. 1985), *cert. denied*, 106 S. Ct. 791 (1986).

35 See *Olympus*, 627 F. Supp. at 922; *COPIAT*, 598 F. Supp. at 851-52; *Vivitar*, 593 F. Supp. at 436.

36 761 F.2d 1552 (Fed. Cir. 1985).

37 See *id.* at 1570.

38 See *id.* at 1569.

39 *Id.* at 1570-71.

40 Neither party in *Vivitar* represented that the regulations were anything other than an interpretation of the statute or that the regulations covered less than the full reach of the statute. See Allen, *supra* note 25, at 36.

41 *Vivitar*, 761 F.2d at 1570. The effectiveness of this remedy depends, however, upon



## II. Analysis of the Validity of the Customs Regulations

Courts have upheld the customs regulations on alternative grounds: (1) the legislative history of section 526, (2) the antitrust doctrines set forth in *Guerlain*, (3) deference to agency interpretation, (4) congressional acquiescence, and (5) the authority and/or discretion vested in the Customs Service to limit the scope of section 526.

### A. *The Legislative History of Section 526*

The most persuasive argument for invalidating the customs regulations is the lack of ambiguity of the language of section 526.<sup>42</sup> The text of section 526 does not indicate that Congress intended the protections of the statute to turn on subtleties of corporate relationships. When Congress has desired such a distinction, it has known precisely how to write a statute to accomplish that objective.<sup>43</sup>

Nevertheless, courts have glossed over the plain meaning of the statute<sup>44</sup> despite government statements that the courts should consider section 526 "in accord with the normal meaning of the statutory language."<sup>45</sup> Instead, the courts have focused on legislative history. The central question is whether Congress meant what it said or whether Congress merely intended to correct the inequities of the Second Circuit decision in *Katzel*.<sup>46</sup> The latter argument suggests that courts should restrict section 526 to the facts of *Katzel*

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Customs' interpretation of the *Vivitar* dicta. The opinion did not explicitly define the scope of protection available. It is unclear whether an exclusionary order would encompass only the gray market goods imported by named defendants or would exclude all parallel imports. See Appellant's Petition for Rehearing and for Clarification at 9, *Vivitar*, 761 F.2d 1552.

<sup>42</sup> See *Olympus*, 627 F. Supp. at 921 ("Section 526 read literally would indeed give [Olympus] the right to exclude all goods bearing the Olympus trademark."); *Vivitar*, 593 F. Supp. at 425 (the literal language of § 1526(a) supports *Vivitar*'s right to require exclusion of all goods bearing the *Vivitar* trademark). When the terms of a statute are unambiguous, judicial inquiry is complete except in "rare and unusual circumstances. . . . And there must be something to make plain the intent of Congress that the letter of the statute is not to prevail." *TVA v. Hill*, 437 U.S. 153, 187 n.33 (1978). In interpreting a statute, one starts with the statutory words as the best evidence of what the legislature intended. *Securities Indus. Ass'n v. Board of Governors*, 468 U.S. 137, 144 (1984).

<sup>43</sup> See, e.g., Federal Aviation Act § 101(16), 49 U.S.C. § 1301(16) (1982); Foreign Agents Registration Act, 18 U.S.C. § 2386(A) (1982).

<sup>44</sup> See Wald, *Some Observations on the Use of Legislative History in the 1981 Supreme Court Term*, 68 IOWA L. REV. 195 (1983) (The plain meaning rule "has effectively been laid to rest. No occasion for statutory construction now exists when the Court will *not* look at the legislative history." (emphasis in original)).

<sup>45</sup> Amicus Brief, *supra* note 28, at 8-9, quoted in *Vivitar*, 761 F.2d at 1568.

<sup>46</sup> Judge Learned Hand correctly noted that "[h]ad the Supreme Court reversed [*Katzel*], [§ 526] would not have been enacted at all." *Coty, Inc. v. Le Blume Import Co.*, 292 F.2d 264, 268-69 (S.D.N.Y. 1923). But, as his cousin, Judge Augustus Hand, later observed, *Katzel* "doubtless brought about the legislation . . . but this fact does not settle the scope of

and should therefore apply it only to independent trademark owners unaffiliated with a foreign manufacturer.<sup>47</sup> Unfortunately, the legislative history is sparse and sheds very little light on congressional intent. As the court in *Vivitar* concluded, "no limitations, based upon congressional intent at the time of enactment, can be read into the statute."<sup>48</sup>

Constant reference to the facts of *Katzel* dominated the brief Senate floor debate in 1922. Some Senators construed the language of section 526 as reaching beyond the facts of *Katzel*,<sup>49</sup> but many Senators misunderstood the facts of the case.<sup>50</sup> Although the conference committee report<sup>51</sup> provides some support for a broader interpretation of the statute,<sup>52</sup> "the [Senate] debate is too unfocused and misinformed to serve as any definitive basis for interpretation of [section 526]."<sup>53</sup>

The effort to discern the legislative intent of Congress in 1922 "turns legal research into quasi-archeology."<sup>54</sup> The attempt to "contradict [section 526's] plain meaning by snatching at fragments

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the act." *Sturges v. Clark D. Pease, Inc.*, 48 F.2d 1035, 1037 (2d Cir. 1931). See Note, *supra* note 23, at 96-98.

47 See Note, *supra* note 23, at 92 n.38.

48 *Vivitar*, 761 F.2d at 1565.

49 See 62 CONG. REC. 11,602-05 (1922). There was obvious concern not just about independent trademark owners, but about foreign control. For example, Senator Edge asked whether a foreign manufacturer could, through an agent in this country, register his trademarks and then control the distribution of goods bearing those trademarks. *Id.* at 11,605. Concern over foreign control was later resolved in committee. See note 51 *infra*. For more extensive discussions of the Senate debates, see *Vivitar*, 761 F.2d at 1562-63; Note, *supra* note 23, at 91-93 nn.35-40.

50 Some Senators obviously believed that *Katzel* involved importation by the very company that had sold the trademark rights. They thus assumed that a species of fraud had been practiced. See 62 CONG. REC. 11,603 (1922). The presence of fraud, however, was expressly negated in the conference committee report ultimately approved by Congress. See note 51 *infra*.

51 See H.R. REP. NO. 1233, 67th Cong., 2d Sess. 158 (1922). The report stated that:

A recent decision of the circuit court of appeals holds that existing law does not prevent the importation of merchandise bearing the same trade-mark as merchandise of the United States, if the imported merchandise is genuine and if there is no fraud upon the public. The Senate amendment makes such importation unlawful without the consent of the owner of the American trade-mark, in order to protect the American manufacturer or producer; and the House recedes with an amendment requiring that the trade-mark be owned, at the time of importation, by a citizen of the United States or by a corporation or association created or organized within the United States.

52 The committee reports are the most clear and authoritative legislative history and are an infinitely more reliable guide to congressional intent than floor debates. Zuber v. Allen, 396 U.S. 168, 186 (1969). They reflect "the considered and collective understanding of those Congressmen involved in drafting and studying proposed legislation." *Id.*

53 *Vivitar*, 761 F.2d at 1563.

54 N. Lewin, The Ten Commandments of Parallel Importation 1 (Oct. 23, 1985) (unpublished paper presented to Second Annual Judicial Conference of the U.S. Ct. Int'l Trade) (available in the files of the Notre Dame Law Review).

from its legislative history is unconvincing [and there is] no compelling reason to doubt that the statute means what it says."<sup>55</sup> Neither the language nor the legislative history contains any indication of any intent by Congress to limit the scope of section 526 based upon distinctions in corporate relationships.

### B. *The Guerlain Rationale*

Customs originally based the current regulations upon *United States v. Guerlain, Inc.*,<sup>56</sup> thereby implementing Customs' perception of antitrust policy as of 1972. But *Guerlain* conflicted with antitrust law when the court decided it<sup>57</sup> and it was vacated and dismissed upon the Antitrust Division's own request.<sup>58</sup> More importantly, the *Guerlain* analysis conflicts with current antitrust law.

The *Guerlain* court determined that the foreign manufacturer and the United States trademark owner constituted a "single international enterprise"<sup>59</sup> and constructed a "relevant market" consisting of transactions in a single trademarked product.<sup>60</sup> The court held that the use of section 526 to exclude gray market imports was monopolization of or an attempt to monopolize the relevant market in violation of section 2 of the Sherman Act.<sup>61</sup>

Courts have since repudiated this extremely narrow definition of "relevant market" as a predicate for antitrust liability.<sup>62</sup> Under current law, a trademark owner seeking exclusion of gray market goods which may reduce or eliminate intrabrand competition does not possess sufficient market power to monopolize the relevant market if significant interbrand competition exists.<sup>63</sup> Thus, the Antitrust Division admitted in 1983 that "[t]o the extent that [*Guerlain*]

55 *Osawa & Co. v. B & H Photo*, 589 F. Supp. 1163, 1175 (S.D.N.Y. 1984).

56 *See note 25 supra*. *See also COPIAT*, 598 F. Supp. at 851.

57 *See generally United States v. E.I. duPont de Nemours & Co.*, 351 U.S. 377 (1956); *Handler, Trademarks—Assets or Liabilities?*, 48 TRADEMARK REP. 661 (1958).

58 While the case was on appeal to the Supreme Court, the Justice Department moved to vacate the judgment and to dismiss the complaint. The case was remanded and dismissed with prejudice. *Guerlain* has no precedential value, even for another court, because the Supreme Court vacated the judgment. *See, e.g., Los Angeles County v. Davis*, 440 U.S. 625, 634 n.6 (1979); *O'Connor v. Donaldson*, 422 U.S. 563, 577-78 n.12 (1975). The Government took such action because the Customs Service felt constrained to exclude imports under authority of § 526 while the Antitrust Division advocated free importation on antitrust grounds. The Solicitor General thus indicated that the Administration would recommend legislation to reconcile the conflicting views of the Executive branch. The result was the ill-fated Celler bill. *See note 17 supra*. *See also Note, supra note 23*, at 94 nn.53-54.

59 *See Guerlain*, 155 F. Supp. at 82.

60 *See id.* at 83-87.

61 *See id.* at 87. *See also note 26 supra*.

62 *See, e.g., Rice v. Norman Williams Co.*, 458 U.S. 654, 661-62 (1982); *Muenster Butane, Inc. v. Stewart Co.*, 651 F.2d 292, 295-96 (5th Cir. 1981).

63 *See Victor, supra note 31*, at 801. "Interbrand competition is the competition among the manufacturers of the same generic product . . . and is the primary concern of antitrust law . . . . In contrast, intrabrand competition is the competition between the distributors—

held that each trademarked good constituted a separate product market solely because of the protection afforded by the trademark, its analysis is inconsistent with current legal precedent and sound economic analysis."<sup>64</sup>

Although courts have repudiated the antitrust reasoning of *Guerlain*, the fact remains that *Guerlain* alone formed the basis of the Customs Service regulations.<sup>65</sup> Even if the *Guerlain* reasoning was valid, the wisdom and necessity for such customs regulations is questionable.<sup>66</sup> The Customs Service does not possess antitrust expertise or authority,<sup>67</sup> and "[a]ntitrust questions are far too complex to reasonably be decided by reference to a short questionnaire on corporate ownership."<sup>68</sup>

### C. *Deference to Administrative Interpretation*

Courts have relied, in part, upon deference to "longstanding and consistent administrative interpretation" of section 526 as grounds for upholding the customs regulations.<sup>69</sup> While courts should defer to reasonable interpretations by agencies administering a statute, deference must stop when the agency's reading cannot reasonably be harmonized with the statute's terms.<sup>70</sup> No reasonable way exists to harmonize the customs regulations with the language of section 526.

Moreover, the amount of deference owed depends upon the "thoroughness, validity and consistency of an agency's reason-

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wholesale or retail—of the product of a particular manufacturer." *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36, 52 n.19 (1977).

64 Amicus Brief, *supra* note 28, at 15 n.12.

65 See *COPIAT*, 598 F. Supp. at 851; note 25 *supra*.

66 See *Osawa*, 589 F. Supp. at 1177-78. The regulations are "unsound both as antitrust policy and as trademark law."

67 The only governmental agencies accorded general antitrust enforcement powers are the Justice Department, 15 U.S.C. §§ 4, 9 (1982), and the Federal Trade Commission, *id.* § 21. While special antitrust enforcement powers have been granted in specific areas of commerce, the FTC has been entrusted with enforcement powers over all other areas of commerce. *Id.* § 21(a).

68 *Osawa*, 589 F. Supp. at 1177.

69 See *Olympus*, 627 F. Supp. at 922; *COPIAT*, 598 F. Supp. at 851; *Vivitar*, 593 F. Supp. at 432-33. *But see Vivitar*, 761 F.2d at 1568.

70 The Court of International Trade in *Vivitar* and the district court in *COPIAT* each considered the customs regulations to be a "reasonable" interpretation of the statute, yet made no attempt to harmonize the statutory language with the interpretation. See *COPIAT*, 598 F. Supp. at 851-52; *Vivitar*, 593 F. Supp. at 433-34. Yet, in the cases the *COPIAT* court cited for authority, the Supreme Court went to great lengths to rationalize how the statutory language and the agency interpretation could be harmonized. See *Bob Jones Univ. v. United States*, 461 U.S. 574 (1983) (harmonizing the word "charity"); *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367 (1969) (harmonizing the "public interest standard").

ing."<sup>71</sup> Customs' reasoning has been erratic<sup>72</sup> and is invalid in light of current antitrust law.<sup>73</sup> The only deference courts should afford Customs' interpretations of section 526 is to the contemporaneous 1923 and 1931 regulations which were entirely consistent with section 526.<sup>74</sup>

Courts do, albeit infrequently, find an implied exception to a statute, difficult or impossible to discern on its face, to avoid an absurd result that the legislature could not have intended.<sup>75</sup> Yet granting protection to valuable property rights is surely not an absurd result. Courts cannot ignore Congress' decision simply because the agency believes Congress should have taken another view. Thus, the deference arguments are not persuasive.<sup>76</sup>

#### D. *Congressional Acquiescence*

Courts have also upheld the customs regulations under the doctrine of *Haig v. Agee*.<sup>77</sup> When Congress knows of an agency interpretation and Congress either amends the statute in part or refuses to act, the administrative interpretation is presumed consistent with the statute.<sup>78</sup> Under this view, Congress ratified the customs regulations each time it considered section 526 without altering the main provisions of the statute.<sup>79</sup>

The counter-arguments are more persuasive. Each time Congress has been presented with a clear opportunity to integrate the regulations into section 526, it has declined to do so.<sup>80</sup> Also, evidence exists which shows that Congress was not always fully in-

71 *Federal Elections Comm'n v. Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 37 (1981).

72 See notes 18-24 *supra* and accompanying text. Between 1923 and 1935, the agency interpretation was consistent with the statute. Between 1936 and 1957, the agency interpretation technically applied only to § 27 of the Trade-Mark Act of 1905 (see note 20 *supra*) and was never explained publicly. Between 1957 and 1983, the agency based its interpretation upon antitrust policies in *Guerlain* which have since been repudiated. Since 1983, the agency has based its interpretation upon legislative history, congressional acquiescence, or deference to longstanding practices. See also Note, *supra* note 23, at 98-101.

73 See text accompanying notes 56-64 *supra* and notes 124-42 *infra*.

74 See *Zenith Radio Corp. v. United States*, 437 U.S. 443, 450 (1978). See also notes 18-19 *supra* and accompanying text.

75 See *Church of the Holy Trinity v. United States*, 143 U.S. 457, 460 (1892). But courts should apply this rule only in rare circumstances. See *United States v. Rutherford*, 442 U.S. 544, 555 (1979).

76 See *Vivitar*, 761 F.2d at 1568 ("the 'long standing administrative interpretation' argument . . . does not afford a basis for a definitive statutory interpretation.").

77 453 U.S. 280, 297-98 (1981).

78 See *Olympus*, 627 F. Supp. at 922; *COPIAT*, 598 F. Supp. at 851-52; *Vivitar*, 593 F. Supp. at 432-33. But see *Vivitar*, 761 F.2d at 1568.

79 See note 17 *supra*.

80 See *id.* "[I]t is particularly risky to draw inferences from subsequent congressional refusals to act." Wald, *supra* note 44, at 205 (emphasis in original). There are many reasons why Congress might have rejected particular legislation. But it is equally as valid to say

formed as to the scope of the customs regulations.<sup>81</sup> Finally, the evidence of congressional ratification is not of the compelling nature that courts usually require when relying on the doctrine.<sup>82</sup> The *Vivitar* court concluded that "legislation by total silence is too tenuous a theory to merit extended discussion."<sup>83</sup>

### E. Authority to Promulgate Regulations

Section 526 expressly directs Customs to enforce the law by seizing genuine trademarked goods imported without the trademark owner's consent.<sup>84</sup> Nevertheless, courts have simply assumed that Customs has the authority to promulgate regulations which deny the protections of the statute to certain trademark owners.<sup>85</sup> Alternatively, the *Vivitar* court concluded that, even without such authority, Customs has the discretion to decide whether to enforce the statute to its full reach.<sup>86</sup>

Neither the statutory language nor the legislative history of section 526 suggest that Congress granted Customs the power to reshape or limit the scope of the statute. Section 526 does not provide the agency with sweeping powers nor does it direct the agency to protect the "public interest."<sup>87</sup> The language of section 526 is commanding and contemplates full enforcement of the statute. As

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Congress ratified the statute as it is to say Congress ratified the regulations. See Note, *supra* note 23, at 95-96 nn.61-62.

81 Congress was not fully informed of the scope of the customs regulations in 1978 when it amended § 526. The reports of the Senate committee and the conference committee describe § 526 simply as "prohibit[ing] importation of goods bearing a trademark owned by a corporate or real citizen of the United States . . . ." S. REP. NO. 778, 95th Cong., 2d Sess. 33 (1978); H.R. REP. NO. 1517, 95th Cong., 2d Sess. 16 (1978). In contrast, the House committee report takes notice of the 1972 customs regulations, but does not mention corporate relationships or the "same ownership" or "common control" provisions of the regulations. See H.R. REP. NO. 621, 95th Cong., 1st Sess. 27 (1977). Congressional acquiescence to an administrative interpretation requires that "Congress must not only have been made aware of the administrative interpretation, but must also have given some 'affirmative indication' of such intent." *Association of Am. Railroads v. ICC*, 564 F.2d 486, 493 (D.C. Cir. 1977).

82 See *Bob Jones Univ.*, 461 U.S. at 599-602 (racial discrimination); *Agee*, 453 U.S. at 299-300 (threat to national security). See also Note, *supra* note 23, at 96 n.62 (distinguishing *Agee*).

83 *Vivitar*, 761 F.2d at 1568.

84 See 19 U.S.C. § 1526(b) (1982) ("Any such merchandise imported into the United States in violation of the provisions of [§ 1526(a)] shall be subject to seizure and forfeiture for violation of the customs laws." (emphasis added)).

85 Several courts have avoided the authority issue. Instead, they have apparently assumed that the regulations were properly issued pursuant to general authority under 19 U.S.C. § 1624 (1982). The courts have focused instead upon the deference and congressional acquiescence arguments. See notes 69 and 78 *supra* and accompanying text. *But see Vivitar*, 761 F.2d at 1569 (Congress did not delegate legislative authority to Customs).

86 See *Vivitar*, 761 F.2d at 1569-70.

87 See, e.g., *Red Lion Broadcasting Co. v. FCC*, 395 U.S. 367 (1969) (discussing the broad "public interest" standard of the Communications Act).

the *Vivitar* court stated, "we find no language in the statute by which Congress delegated . . . legislative authority to the Secretary of the Treasury in connection with [the] administration of [section 526]."88

To the extent that special authority does exist under section 526, it has been granted expressly by congressional amendment. For example, in 1978 Congress empowered Customs to determine what products may be brought into the United States for personal consumption,<sup>89</sup> an area of unique Customs expertise. In contrast, Customs has no special expertise either in trademark or antitrust matters. "Nothing in the statute suggests that Congress conferred authority on . . . Customs to condition its benefits on Customs' analysis of antitrust policy."<sup>90</sup>

Justifying the customs regulations as mere discretionary enforcement guidelines is equally questionable. Following the surprising<sup>91</sup> *Vivitar* decision, both trademark owners and gray marketeers have argued persuasively that discretionary enforcement is contrary to the language of section 526,<sup>92</sup> to Supreme Court decisions,<sup>93</sup> and to the agency's own position and practices.<sup>94</sup> Thus, little dispute exists that the enforcement duties of Customs are coextensive with the scope of section 526.

The foregoing analysis demonstrates that there is little legal foundation for the customs regulations. The regulations are not supported by the legislative intent of the statute, the underlying antitrust rationale, the deference owing to agency interpretation, or the congressional acquiescence doctrine. Moreover, the Customs Service does not have the necessary authority to promulgate such regulations. As a matter of law, section 526 *must* be enforced.

The ultimate question, however, is whether section 526 *should* be enforced. It is therefore necessary to consider, and then strike a proper balance between, the policies underlying the protection of

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88 *Vivitar*, 761 F.2d at 1569 (emphasis and footnotes omitted).

89 See note 17 *supra*.

90 *Osawa*, 589 F. Supp. at 1177.

91 See note 40 *supra*.

92 See, e.g., Reply Brief for Appellants at 30, *COPIAT*, No. 84-5890 (D.C. Cir. Dec. 28, 1984) ("[Th]e language [of § 526(b)] clearly contemplates Customs enforcement of the full lawful scope of section 526(a) at the point of entry."); Brief for 47th Street Photo, Inc., *supra* note 23, at 54-55 ("The statute does not authorize Customs to pick and choose when it will and when it will not exercise its obligation to detain prohibited goods. Hence the Federal Circuit is simply wrong when it implies that 'Customs is not required to exclude' all the goods defined by [§ 526(a)].").

93 See *A. Bourjois & Co. v. Aldridge*, 263 U.S. 675 (1923) (Customs is *required* to exclude gray market imports). See also note 16 *supra*.

94 Customs authorities have always deemed themselves legally constrained to exclude goods they considered prohibited by § 526. See, e.g., note 25 *supra*.

intellectual property rights and the protection of consumer interests.

### III. The Policy Considerations

A trademark<sup>95</sup> performs several functions which deserve protection: (1) it acts as the objective symbol of the goodwill or reputation which a business has created for its product;<sup>96</sup> (2) it identifies the seller's goods and distinguishes them from goods sold by another;<sup>97</sup> (3) it signifies that all goods bearing the trademark come from a single source;<sup>98</sup> (4) it signifies that all goods bearing the trademark are of an equal level of quality;<sup>99</sup> and (5) it serves as the prime instrument in selling and advertising the goods.

Protection of trademarks serves diverse private and public interests.<sup>100</sup> In addition, societal norms encourage vigorous competition and low prices, yet seek to prohibit unfair competition and commercial immorality. The challenge in the gray market is to find the proper policy balance between fair competition and free competition<sup>101</sup> while maximizing consumer protection.

95 "The term 'trade-mark' includes any word, name, symbol, or device or any combination thereof adopted and used by a manufacturer or merchant to identify his goods and distinguish them from those manufactured or sold by others." 15 U.S.C. § 1127 (1982).

96 See, e.g., *Mishawaka Rubber & Woolen Mfg. Co. v. S.S. Kresge Co.*, 316 U.S. 203, 208 (1942); *Hanover Star Milling Co. v. Metcalf*, 240 U.S. 403, 414 (1916); S. REP. NO. 1333, 79th Cong., 2d Sess. 3 (1946) ("Where the owner of a trademark has spent energy, time, and money in presenting to the public the product, he is protected in his investment from its misappropriation by pirates and cheats."). See generally 1 J. McCARTHY, TRADEMARKS AND UNFAIR COMPETITION, § 2:10 (2d ed. 1984).

97 A major purpose of trademarks is "to protect the public so that it may be confident that, in purchasing a product bearing a particular trademark that it favorably knows, it will get the product which it asks for and wants to get." S. REP. NO. 1333, 79th Cong., 2d Sess. 3 (1946). See generally 1 J. McCARTHY, *supra* note 96, § 3:2.

98 Historically trademarks indicated the physical source of origin of the goods, but the source function of trademarks is now more broadly construed. See, e.g., *Fleischmann Distilling Corp. v. Maier Brewing Co.*, 314 F.2d 149, 155 (9th Cir. 1963) ("Buyers are entitled to assume that all products carrying the same trademark are somehow linked with, or sponsored by, a single anonymous source."). See generally 1 J. McCARTHY, *supra* note 96, § 3:3.

99 The trademark indicates a unified source of quality control. Thus, the dual nature of a trademark is either to indicate source or quality or both, depending upon manner of use. See, e.g., *Application of Abcor Development Corp.*, 588 F.2d 811, 814 n.15 (C.C.P.A. 1978) ("[A] mark primarily functions to indicate a single quality control source of the goods."). See generally 1 J. McCARTHY, *supra* note 96, § 3:4.

100 See notes 96-99 *supra* and accompanying text. Trademark owners are protected against diversion of sales and pirating of goodwill. The trademark also protects the consuming public from deception and likelihood of confusion.

101 See generally 1 J. McCARTHY, *supra* note 96, § 2:2. Trademark law is a branch of the broader area of unfair competition. While trademark law focuses upon the total physical image given by the product and its mark, unfair competition is much broader in scope and encompasses buyer confusion between two products based upon the total impact of all aspects of a party's selling efforts. *Id.* As in the case of trademark infringement, likelihood of confusion is the cornerstone of unfair competition. The law of unfair competition there-



### A. *Protection of Trademark Rights in the Gray Market*

Advocates of the gray market argue that once a foreign trademark owner introduces genuine trademarked goods into the stream of commerce, his right of control ends and an affiliated United States trademark owner has no right to control their ultimate disposition.<sup>102</sup> This exhaustion theory is flawed because it ignores the territoriality doctrine expressed in section 526 and *Katzel*: in international trade, a trademark symbolizes the geographically distinct goodwill of the domestic owner of the mark.<sup>103</sup> The exhaustion theory does not apply as long as the United States trademark owner has established an independent goodwill.<sup>104</sup>

In private trademark litigation, courts determine the existence of independent goodwill on a case-by-case basis.<sup>105</sup> The language of section 526, however, encompasses all domestic trademark owners. Thus, broad enforcement of section 526 as a trademark law<sup>106</sup> requires the assumption that United States trademark owners, as a class, have demonstrated such geographically distinct goodwill. Most segments of the gray market reflect the validity of this assumption.<sup>107</sup>

Parallel importation is most pronounced when there is a large disparity between the costs of shipping products into this country and the costs incurred by authorized United States distributors in marketing those products.<sup>108</sup> The markets most prone to gray mar-

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fore protects consumers from competitive excesses. In contrast, antitrust law protects consumers at the other end of the spectrum by ensuring aggressive competition.

102 See Lewin, *supra* note 54, at 2.

103 See note 16 *supra*.

104 See *Weil Ceramics & Glass, Inc. v. Dash*, 618 F. Supp. 700, 706-13 (D.N.J. 1985); *Osawa*, 589 F. Supp. at 1171-74. See also Note, *supra* note 23, at 108-09.

105 See, e.g., *Weil*, 618 F. Supp. at 711-13; *Osawa*, 589 F. Supp. at 1171-74.

106 Despite Congress' attaching § 526 to a customs law, little dispute exists that it is a trademark law. The unfair competition inherent in *Katzel* stimulated the adoption of § 526. See notes 10 and 16 *supra* and accompanying text. The statute is closely related, by history, cross-reference, and otherwise, to § 42 of the Lanham Act and is administered by the Customs Service under the same regulations. Both trademark owners and the Government now concur that § 526 is indeed a trademark law. See Reply Brief for Appellants at 34, *COPIAT*, No. 84-5890 (D.C. Cir. Dec. 28, 1984).

107 It is improbable that all United States trademark owners have established such independent goodwill. However, analysis of the proper scope of § 526 must account for legitimate trademark expectations in the majority of situations encompassed by the statute. Full enforcement of § 526 could be overinclusive to the extent that some mark owners may not have established independent goodwill. But, if these mark owners represent only a small minority of cases, it is preferable to protect the intellectual property rights of the majority under the statute. Where such independent goodwill is in doubt, the protections of the statute may be denied on a case-by-case basis.

108 Some of the most heavily publicized markets are cameras, optics, home electronics products, watches, perfumes, batteries, and tires. See *Lexecon*, *supra* note 4, at 2. In these markets, The Coalition to Preserve the Integrity of American Trademarks (COPIAT) has reported that domestic marketing expenditures ranged from 8% to 25% of the distributor's United States sales price (3% to 14% of this total was advertising alone). In contrast, ship-

ket importation possess several common characteristics.<sup>109</sup> They are generally competitive markets in which the exclusive American distributors have chosen to invest heavily in both informational and promotional advertising. Many of these markets involve relatively sophisticated product lines which require substantial attention to product quality. The selection and training of a specialized group of distributors appears to be common. Finally, most of these products require warranty protection. In each of these areas, trademark owners have committed substantial funds to marketing and distribution. These pre-sale and post-sale investments contribute directly to the creation and maintenance of market reputation and promote interbrand competition.

Most trademark owners in the gray market can thus demonstrate independent goodwill and a favorable reputation in the eyes of consumers. The greater the trademark owner's investment in building and maintaining goodwill, the greater the profit potential for a parallel importer. The result is free riding by the gray marketer on those investments.<sup>110</sup> This free riding reduces the trademark owner's incentive to invest in informative advertising, distributor training, quality control, warranty services, and development of new product opportunities.<sup>111</sup>

The vulnerability of trademark owners to gray market importation increases in direct proportion to their successful investment in furthering interbrand competition. The exclusion of parallel imports by enforcement of section 526 eliminates this free riding

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ing costs to the United States accounted for only 1% of the distributor's United States sales price. *See id.* at 10-11. *See also Osawa*, 589 F. Supp. at 1176.

The International Trade Commission has taken the position that economic considerations do not support gray market imports because: "(1) monopolistic price discrimination rarely exists and ignores demand; (2) price differences are justified by differences in services and investments; [and] (3) grey market goods get a 'free ride' on the reputation enjoyed by the mark . . ." M. Noll, *Gray Market Imports*, Address to the Second Annual Judicial Conference of the U.S. Ct. of Int'l Trade, Oct. 23, 1985, reported at 31 PAT. TRADE-MARK & COPYRIGHT J. (BNA) No. 755, at 36 (Nov. 14, 1985).

109 *See* cases cited at note 33 *supra*.

110 *See* note 96 *supra*. The gray marketer gains from the use of the trademark, and all that it entails, without paying for it. He free rides on the brand advertising and promotion of the authorized distributor and need only advertise low prices. In rebuttal, gray marketers argue that they advertise heavily. *See* Lewin, *supra* note 54, at 20; Brief for 47th Street Photo, Inc., *supra* note 23, at 5; Brief for Amicus Curiae Progress Trading Company, Inc. at 11, *COPIAT*, No. 84-5890 (D.C. Cir. Dec. 28, 1984). Such advertising, however, promotes multiple product lines and low prices. It derives its value from the fact that consumers are already aware of the trademarked goods and their qualities. Thus, gray marketer advertising is evidence of free riding, not a negation of it.

111 *See* 31 PAT. TRADEMARK & COPYRIGHT J. (BNA) No. 755, at 36 (Nov. 14, 1985) (reporting International Trade Commission position that "[g]rey market goods will lead to reduced investments in trademarks and products" and trademark owners' contention that "investments in trademarks—which can be as high as 27 percent of the price of the product—will diminish if the [gray market] goods are not excluded.").

problem. But prevention of free riding represents only one side of the balance. Protection of consumer interests is also vitally important.

### B. *Protection of Consumer Interests in the Gray Market*

A trademark serves consumer interests by differentiating the trademark owner's goods and preventing the likelihood of consumer confusion.<sup>112</sup> At the same time, consumer and societal interests favor vigorous competition which offers the consumer lower prices. While the interests of trademark owners and consumers in preventing confusion are identical, their interests may conflict regarding competition and product pricing.

#### 1. Likelihood of Confusion or Deception

Because parallel importers sell genuine trademarked goods, they argue that there is no possibility, much less likelihood, of confusion as to source of origin of the goods.<sup>113</sup> Modern trademark law does not support this narrow view of confusion. The gray market involves the likelihood of consumer confusion as to both source and quality.

The "source function" of a trademark encompasses more than the geographic origin of the goods.<sup>114</sup> As a result of modern marketing and distribution techniques, "a 'genuine' article to the modern consumer connotes not only the source of manufacture but also the chain of selection, distribution, and servicing upon which he has

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112 See, e.g., *International Order of Job's Daughters v. Lindeburg*, 633 F.2d 912, 919 (9th Cir. 1980) ("[T]he 'property right' or protection accorded a trademark owner can only be understood in the context of trademark law and its purposes. A trademark owner has a property right only insofar as is necessary to prevent consumer confusion."); *James Burrough Ltd. v. Sign of Beefeater, Inc.*, 540 F.2d 266, 276 (7th Cir. 1976) ("Trademark laws exist not to 'protect' trademarks, but . . . to protect the consuming public from confusion, concomitantly protecting the trademark owner's right to a non-confused public."). See generally 1 J. McCARTHY, *supra* note 96, § 2:6.

113 The courts are split on the question of whether genuine goods can cause confusion. For discussions of courts finding confusion, see *Katzel*, 260 U.S. at 692 (1923); *Weil*, 618 F. Supp. at 704; *Osawa*, 589 F. Supp. at 1167-70; *Bell & Howell*, 548 F. Supp. at 1071. For discussions by other courts questioning whether any confusion may exist in genuine goods, see *Bell & Howell*, 719 F.2d at 46; *Monte Carlo Shirt, Inc. v. Daewoo Int'l*, 707 F.2d 1054, 1058 (9th Cir. 1983) (applying California law); *DEP Corp. v. Interstate Cigar Co.*, 622 F.2d 621, 622 n.1 (2d Cir. 1980); *El Greco Leather Prods. Co. v. Shoe World, Inc.*, 599 F. Supp. 1380, 1394 (E.D.N.Y. 1984).

114 See note 98 *supra*. Section 32 of the Lanham Trade-Mark Act provides additional support. Section 32 originally required a showing that the infringing use was likely to confuse or deceive purchasers as to the source of origin of such goods and services. In 1962, Congress amended § 32, deleting the source of origin requirement, demonstrating a clear purpose "to outlaw the use of trademarks which are likely to cause confusion, mistake or deception of any kind, not merely of purchasers nor simply as to source of origin." *Syntex Laboratories, Inc. v. Norwich Pharmacal Co.*, 437 F.2d 566, 568 (2d Cir. 1971).

been able to rely in the past."<sup>115</sup> The authorized distributor is the "sponsor" of the trademarked good and provides many ancillary services. Confusion is likely to result if the gray marketeer does not disclose that he is not the authorized distributor or that he does not offer the warranty protection or services which the consumer has come to expect.<sup>116</sup>

The "quality function" of the trademark does not replace the "source function," but stands alongside it as a "guarantee" of consistent quality.<sup>117</sup> In the gray market, genuine trademarked goods possess identical product quality when shipped from the factory. Product quality, however, is not simply measured at the factory: it is also determined at the time of retail sale. Thus, many trademark owners invest in product quality through careful shipping, storage, inventory control, and quality control.<sup>118</sup> This investment is a natural adjunct of the desire to protect the reputation of the product. In contrast, gray marketeers may unknowingly sell inferior products because they provide less quality control and have less incentive to make such expenditures.<sup>119</sup> Inferior products confuse and deceive the consumer and his expectations are disappointed.<sup>120</sup>

Gray market products therefore are only superficially identical to goods supplied by authorized distributors. By virtue of the trademark owner's commitment to pre-sale quality control and post-sale warranties and service, he is in fact selling a different

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115 Callman, *Another Look at the Unlawful Importations of Trademarked Articles*, 52 TRADEMARK REP. 556, 561 n.15 (1962).

116 The United States trademark owner who offers warranty and repair services to his customers faces major problems as a result of consumer confusion. He can restrict his services to those who purchased goods through authorized outlets, but if he does so, he may engender hostility to the mark and lower its value in the marketplace. On the other hand, if he chooses to honor warranty requests from consumers who purchased from gray market importers, he has increased his investment in marketing, making him even more vulnerable to free riding by parallel importers.

117 See note 99 *supra*. Parallel importers are likely to cause confusion as to the identity of the company standing behind and insuring the quality of the trademarked goods. See *Bell & Howell*, 548 F. Supp. at 1071.

118 See, e.g., *Weil*, 618 F. Supp. at 711-12; *Osawa*, 589 F. Supp. at 1165-68; Complainant Duracell Inc.'s Post Hearing Brief at 18-22, *In re Certain Alkaline Batteries*, Inv. No. 337-TA-165 (U.S. ITC 1984).

119 See Callman, *supra* note 115, at 561 n.15 ("If varying articles appear under the same trademark in the same country, because goods destined for country A are imported into country B, the public will be confused with respect to the article's identity or 'genuineness.' Here the infringement attacks the trademark's guarantee function; the public, which believes that all goods bearing the same mark come from the same source and are of the same quality, will be misled."). This confusion results in deterioration of reputation and lost future sales, costs which are borne by the U.S. trademark owner.

120 This situation could develop where, for example, goods are damaged in transit, goods are not designed for the United States market (foreign language instruction manuals, improper power cords, etc.), see, e.g., *Osawa*, 589 F. Supp. at 1169, or where goods are sensitive to storage/shipping conditions and deteriorate in quality, see, e.g., Post Hearing Brief, *supra* note 118, at 18-22.

product than that offered by the gray marketeer. When the consumer comes to expect such services, confusion rather than differentiation results from gray market importation.

## 2. Competition and Product Pricing

It is imprecise to define a trademark as a "monopoly conferred by law."<sup>121</sup> A trademark right is not a monopoly right "in the anti-trust sense of an evil anticompetitive monopoly."<sup>122</sup> The trademark right simply provides the exclusive right to use the mark in commerce; it does not by itself confer either market power or monopoly power over competition or prices.

In the gray market, the United States trademark rights are often owned by exclusive distributors affiliated with foreign product manufacturers. Parallel importers have thus argued that prohibition of gray market importation will foster "anti-competitive practices, discriminatory pricing, and violations of antitrust laws and policy."<sup>123</sup> While overstated, these contentions warrant careful scrutiny.

Parallel importers argue that enforcement of section 526 would allow related companies to engage in an international conspiracy to divide world markets in violation of section 1 of the Sherman Act.<sup>124</sup> This contention is without merit. Conspiracies to divide world markets are actionable where there is agreement among horizontal competitors.<sup>125</sup> But the Supreme Court has held that a parent and subsidiary cannot conspire with one another within the meaning of the antitrust laws.<sup>126</sup> And the Antitrust Division has stated that "a parent corporation may rationally allocate territories or set prices for the subsidiaries it fully controls."<sup>127</sup> Thus, in the typical gray market situation, a multinational corporation may establish an exclusive distribution system among its na-

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121 *Osawa*, 589 F. Supp. at 1176.

122 1 J. McCARTHY, *supra* note 96, § 2:5.

123 *Osawa*, 589 F. Supp. at 1176.

124 See 15 U.S.C. § 1 (1982) ("Every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States, or with foreign nations, is . . . illegal.").

125 See, e.g., *United States v. Sealy, Inc.*, 388 U.S. 350 (1967); *Timken Roller Bearing Co. v. United States*, 341 U.S. 593 (1951). *Timken* involved an agreement between related horizontal competitors to divide world markets, but the agreement between the parties arose before there was any relationship between them. *Sealy* involved a group of competitors who formed a joint venture "parent company" to exploit the trademark and enforce agreed-upon exclusive territories. Neither case involved a multinational parent company structuring its vertical distribution operations through a series of foreign subsidiaries. Instead, both cases involved agreement by horizontally situated actual or potential competitors.

126 See *Copperweld Corp. v. Independence Tube Corp.*, 104 S. Ct. 2731 (1984).

127 UNITED STATES DEPARTMENT OF JUSTICE, ANTITRUST GUIDE TO INTERNATIONAL OPERATIONS 12 (1977).

tionally organized marketing subsidiaries.<sup>128</sup> Such action does not constitute an unlawful conspiracy to divide world markets.

In a related argument, parallel importers contend that enforcement of section 526 to restrict gray market imports encourages unreasonable vertical restraint of trade in violation of section 1 of the Sherman Act.<sup>129</sup> This argument disregards interbrand competition and focuses primarily upon the undesirable impact of exclusive distributor agreements on intrabrand competition. Exclusive distributorships establish vertical restraints which were at one time considered per se violations of the Sherman Act.<sup>130</sup> Courts, however, now analyze such arrangements under the antitrust "rule of reason."<sup>131</sup> While exclusive distributor agreements limit intrabrand competition, they may promote more aggressive interbrand competition.<sup>132</sup> It is now well accepted that such exclusive distributor agreements may be lawful and economically efficient to the extent that they facilitate interbrand competition.<sup>133</sup>

Parallel importers further suggest that the exclusion of gray market goods under authority of section 526 would aggravate price discrimination against United States consumers.<sup>134</sup> Under this theory, international trademark owners currently victimize consumers by unilaterally charging higher prices in the United States than in

128 See *In re Certain Alkaline Batteries*, Inv. No. 337-TA-165, reported at [July-Dec] INT'L TRADE REP. (BNA) no. 9, at 239 (Aug. 29, 1984) (U.S. ITC Aug. 10, 1984) (initial decision) (relying upon *Copperweld*, 104 S. Ct. 2731, to conclude that Duracell and its wholly owned subsidiary could not conspire with each other in violation of § 1 of the Sherman Act).

129 See Brief for 47th Street Photo, Inc., *supra* note 23, at 50-53; Victor, *supra* note 31, at 801-02.

130 See, e.g., *United States v. Arnold, Schwinn, & Co.*, 388 U.S. 365 (1967). Courts treated vertical distribution arrangements by manufacturers similarly to horizontal agreements among distributors to restrain geographic competition. This view was heavily criticized. See generally Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282 (1975).

131 The antitrust "rule of reason" as applied to non-price vertical restraints was adopted in *Continental T.V., Inc. v. GTE Sylvania, Inc.*, 433 U.S. 36 (1977), overruling *Schwinn*, 388 U.S. 365. Today, "the legality of a vertical restraint in each case depends upon its economic effect, assessed under a 'rule-of-reason' standard." U.S. Department of Justice, *Vertical Restraints Guidelines*, 50 Fed. Reg. 6264 (1985). Thus, in analyzing non-price vertical restraints, courts compare the effects upon interbrand and intrabrand competition. See Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6 (1981); *Copperweld*, 104 S. Ct. 2731; *Monsanto Co. v. Spray-Rite Service Corp.*, 104 S. Ct. 1464 (1984).

132 See *GTE Sylvania*, 433 U.S. at 57-59.

133 There are many legitimate business reasons why a United States distributor and a foreign manufacturer would choose to do business through an exclusive distributor arrangement. See *GTE Sylvania*, 433 U.S. at 54 (listing several beneficial characteristics of vertical restraints). Judges Posner, Bork, and Easterbrook have each proposed that exclusive distribution by manufacturers should generally be declared lawful. See generally Bork, *Vertical Restraints: Schwinn Overruled*, 1977 SUP. CT. REV. 171; Posner, *supra* note 131; Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1 (1984).

134 See, e.g., *Osawa*, 589 F. Supp. at 1166.

other countries.<sup>135</sup> Parallel importers argue that, if parallel imports are barred, even higher prices might result. But the mere fact that gray market goods cost less in foreign markets does not prove the existence of anti-competitive international price discrimination. Rather, higher United States prices result primarily from greater marketing investments made in the United States by trademark owners than in other countries.<sup>136</sup> While it is true that international price discrimination may exist in the gray market, such discrimination is only feasible in situations where market power and minimal interbrand competition exist.<sup>137</sup> As the International Trade Commission has stated, "monopolistic price discrimination rarely exists" in the gray market.<sup>138</sup>

Parallel importers also suggest that trademark rights will be used to facilitate a horizontal restraint of trade, allowing competitors acting in concert to prevent gray market importation and restrict competition.<sup>139</sup> If such action were by express agreement within an international cartel, the antitrust laws would provide proper remedies.<sup>140</sup> But the mere fact that trademark owners act in a parallel manner to protect their trademark rights under authority of section 526 would be insufficient evidence of such restraint.<sup>141</sup> Admittedly, the antitrust laws do not protect against mere con-

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135 See Atwood, *Import Restrictions on Trademarked Merchandise—The Role of the United States Bureau of Customs*, 59 TRADEMARK REP. 301, 308 (1969) ("Different arms of the same company should not be able to maintain two separate price structures for the same product, one price being above that which the market would seek if importers could compete freely."). Anti-competitive price discrimination occurs when sellers receive a different margin of price over cost from different purchasers. The Robinson-Patman Amendment to § 2 of the Clayton Act proscribes the practice of price discrimination. See 15 U.S.C. § 13 (1982). International price discrimination by a world trademark owner, to the extent it may exist, is generally beyond the reach of Robinson-Patman protections. Transfers from a parent to its subsidiaries are not considered separate sales for Robinson-Patman purposes. See *Security Tire and Rubber Co. v. Gates Rubber Co.*, 598 F.2d 962, 965-66 (5th Cir. 1979). Even if such transfers were treated as separate sales, genuine goods which were originally sold by the manufacturer for resale only in a foreign country would not fall within the scope of the statute.

136 See note 108 *supra* and accompanying text.

137 If aggressive interbrand competition exists in the United States, attempts by a foreign trademark owner to discriminate in price against the United States market would be counter-productive. Interbrand competitors would simply undercut such discriminatory prices and thus reduce the market share of the foreign trademark owner. Therefore, the key practical consideration is whether the trademark owner can exercise market power over the relevant product market; i.e., whether he can raise prices above a competitive level without a substantial loss of business to substitutes or competitors. For a discussion of market power considerations, see *Graphics Products Distrib. v. Itek Corp.*, 717 F.2d 1560, 1570 (11th Cir. 1983); *Valley Liquors, Inc. v. Renfield Importers, Ltd.*, 678 F.2d 742, 745 (7th Cir. 1982); *Muenster Butane, Inc. v. Stewart Co.*, 651 F.2d 292, 296 (5th Cir. 1982).

138 Noll, *supra* note 108, at 36.

139 See Victor, *supra* note 31, at 801-02.

140 See *Osawa & Co. v. B & H Photo*, 589 F. Supp. 1163, 1178 (S.D.N.Y. 1984).

141 See Victor, *supra* note 31, at 801-02.

scious parallelism where foreign companies act independently to restrict competition or maintain high prices in the United States.<sup>142</sup> These concerns may be valid in markets where the domestic industry is an oligopoly, the foreign manufacturers are heavily concentrated in one foreign country, and where the policies of that country encourage industry-wide cooperation. The decision to enforce section 526 must therefore take these concerns into account.

Although price discrimination and conscious parallelism may exist in some cases, parallel importers overstate their antitrust arguments as applied to the entire gray market. Parallel importers, however, respond with a persuasive consumer-oriented policy argument. They contend that exclusion of gray market goods under section 526 would foreclose the availability of lower cost genuine goods and would be detrimental to consumers.<sup>143</sup> Under this view, consumers have purchased gray market goods specifically because of lower prices.<sup>144</sup> The magnitude of the existing gray market<sup>145</sup> provides strong evidence of broad consumer interest in such goods.<sup>146</sup> The question raised is thus whether enforcement of section 526 is likely to result in reduced prices of authorized goods comparable to those now offered in the gray market.

To justify enforcement of section 526 to its full breadth, the elimination of intrabrand competition should increase interbrand

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142 Parallel business behavior does not itself violate the Sherman Act. Likewise, mere conscious price parallelism is not itself unlawful. *See, e.g.,* *Esco Corp. v. United States*, 340 F.2d 1000, 1007 (9th Cir. 1965). The mere opportunity to conspire, in the context of parallel pricing, is not necessarily probative evidence of conspiracy. *See, e.g.,* *Weit v. Continental Ill. Nat'l Bank & Trust Co.*, 641 F.2d 457, 462 (7th Cir. 1981). The inference of unlawful agreement rather than individual business judgment must be the compelling, if not exclusive, rational inference. *Id.* at 463.

143 *See* Brief for 47th Street Photo, Inc., *supra* note 23, at 4-5. Parallel importers provide "significant savings to American consumers" and have established businesses in reliance on the "existing state of the law" and "government's long-standing commitment to free trade in such goods." *Id.* *See also* Victor, *supra* note 31, at 803.

144 *See Osawa*, 589 F. Supp. at 1167 (gray market sales "are based solely on price advantage"); *Parfums Stern, Inc. v. United States Customs Serv.*, 575 F. Supp. 416, 421 (S.D. Fla. 1983) ("[T]he Court would be doing the public a disservice by preventing the dissemination of . . . equally good, yet less expensive [gray market] products."); Note, *Trade-mark Infringement: The Power of an American Trade-mark Owner to Prevent the Importation of the Authentic Product Manufactured by a Foreign Company*, 64 *YALE L.J.* 557, 564 (1955) (the enforcement of § 526 by related companies "merely results in higher prices to consumers").

145 The gray market has grown dramatically during the 1980s and is now well established. *See* Riley, *supra* note 3, at 1, col. 2 (gray market accounts for 33% of the camera market); *Olympus Corp. v. United States*, 627 F. Supp. 911, 916 n.1 (E.D.N.Y. 1985) (K-Mart purchases \$250-300 million of gray market goods per year).

146 Several consumer groups have argued for continued gray market importation. *See, e.g.,* Letters to the U.S. Dept. of the Treasury from Consumers Union (publishers of Consumer Reports) (Jan. 8, 1983), Public Citizen (July 28, 1983), and Consumers for World Trade (May 19, 1983), *reprinted in* Memorandum for 47th Street Photo, Inc. in Opposition to Plaintiff's Motion for Summary Judgment, App. at 52-59, *COPIAT*, 598 F. Supp. 844 (D.D.C. 1984).



competition to an extent beneficial to consumers. The major reason for higher domestic prices of authorized goods is the market-justified price difference caused by aggressive interbrand competition in such goods.<sup>147</sup> Because fierce interbrand competition already exists in most markets subject to gray market importation, price competition among authorized distributors would be unlikely to intensify to any significant extent in the absence of gray market goods.<sup>148</sup> In fact, the reverse is true. Authorized distributors have greater incentives to reduce prices when faced with competition from lower-priced gray market goods.<sup>149</sup> Thus, substantially lower authorized distributor prices would not logically result from the curtailment of gray market imports. Enforcement of section 526 to its full reach could thus have the effect of eliminating intrabrand competition without sufficiently increasing interbrand price competition. Such a result would be detrimental to consumer interests.

The resulting policy balance is complex. If current policies remain in effect, the consumer will benefit from intrabrand competition and lower-priced gray market goods. In addition, the dangers of price discrimination and conscious parallelism would be minimized. But the free riding problem will continue to unfairly burden affected trademark owners. The consumer will continue to suffer from lack of full disclosure and likelihood of confusion. In contrast, enforcing section 526 to prohibit gray market imports would resolve the free riding and confusion problems. Consumers, however, will be denied the benefits of lower prices because intrabrand competition would be curtailed without any likelihood that resulting interbrand competition would stimulate substantially lower prices.

#### IV. Alternative Solutions

Although section 526 is enforceable as a matter of law, policy considerations dictate that neither a blanket exclusion of gray market imports nor a continuation of the status quo strikes an equitable

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147 See note 108 *supra* and accompanying text.

148 The curtailment of gray market imports would stimulate interbrand competition to a certain extent. Trademark owners would have renewed incentives to invest in pre-sale advertising and quality control and post-sale warranties and services. See note 111 *supra* and accompanying text. Arguably, however, the restoration of such competitive incentives would translate into lower consumer prices. At best, some price reduction might be anticipated, but the magnitude of any such price decrease is not likely to approach the level of discounting currently offered by gray marketeers.

149 When the trademark owner suffers diversion of sales as a result of gray market importation, his share of both the branded product market and the relevant interbrand product market deteriorates. To maintain net profits at prior levels, he must either reduce overhead costs or expand his aggregate market share. To gain market share, an obvious alternative is to reduce prices, thereby increasing intrabrand price competition and undercutting interbrand competitor prices.

balance between the protection of trademark rights and the interests of consumers. A proper resolution of the conflict should minimize free riding on trademark owners' goodwill, protect consumers from likelihood of confusion, and allow continued importation of gray market goods. Such a solution should protect the value inherent in the mark—and only the mark—without restricting the availability of gray market goods. At the same time, the policy solution must be simple to enforce and must be economically efficient.

The *Vivitar* court recognized that unfair competition is common in the gray market<sup>150</sup> and suggested that trademark rights be enforced in private litigation rather than by enforcement of section 526.<sup>151</sup> Neither trademark owners nor parallel importers support this approach.<sup>152</sup> Instead, both groups urge definitive resolution of the scope of the statute. While private litigation is not totally unreasonable given all of the possibilities in international trade,<sup>153</sup> consumer confusion and free riding will continue in most gray markets.

The *Vivitar* solution therefore invites a legislative change. Because neither the status quo nor full enforcement of section 526 is desirable and judicial remedies are inadequate, a compromise policy solution and subsequent congressional action are required. At present, the Reagan Administration is considering two possible solutions:<sup>154</sup> (1) a "labeling" policy requiring importers to label their products as neither authorized nor warranted by the domestic

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150 761 F.2d at 1570 ("It appears to us that § 1526(a) may be developing on a case-by-case basis into protection against *sui generis* types of unfair competition in international trade." (footnotes omitted)). The acknowledged purpose of § 526 was to address the inequities of unfair competition inherent in *Katzel*. See notes 10 and 15 *supra* and accompanying text. See also Nolan-Haley, *The Competitive Process and Gray Market Goods*, 5 N.Y.L. SCH. J. INT'L & COMP. L. 231, 250 (1984) ("[T]he phenomenon of gray market goods is . . . a species of unfair competition."). *But cf. Vivitar*, 593 F. Supp. at 435 ("Free riding is regulated under the Lanham Act . . . and other statutory law . . . . There is no evidence that Congress intended [§ 526 as an additional remedy for violations of the law of unfair competition], and the court declines to so interpret it.").

151 761 F.2d at 1570.

152 See, e.g., Reply Brief for Appellants, *supra* note 106, at 29-31; Brief for 47th Street Photo, Inc., *supra* note 23, at 57 ("[The Federal Circuit] opinion is likely to spawn many private lawsuits that will harass importers . . . and will unnecessarily burden the courts."). To demonstrate the validity of this observation, see Critser, *supra* note 3, at 19 ("In 1985 alone, Coleco Industries filed at least 10 gray market suits against unauthorized importers of Cabbage Patch Kids . . . . The strategy . . . is to establish legal precedents by moving against small importers that can't afford a costly defense."). See also Note, *supra* note 23, at 110-11 (private litigation is inadequate because identification of importers is often difficult and because trademark owners will be required to bring an endless series of lawsuits).

153 See *Vivitar*, 761 F.2d at 1570.

154 See note 32 *supra*. See also 31 PAT. TRADEMARK COPYRIGHT J. No. 755, at 36 (Nov. 14, 1985); Riley, *supra* note 3, at 23, col. 2. Other solutions have been proposed, but they have not received serious attention. See Note, *supra* note 23, at 111-15.

trademark owner; or (2) a "demarking" policy requiring that the trademark be removed or obliterated prior to importation.

To eliminate the likelihood of consumer confusion, clear labeling of gray market goods should be required. The labeling should disclose that the gray market goods are not sponsored by the authorized distributor and that warranties, repair services, or rebates are not available from that source.<sup>155</sup> A labeling policy provides an administratively simple "bright line" standard which reduces consumer confusion and yet allows gray market importation to continue. Arguably, however, labeling provides insufficient protection against consumer confusion and free riding. The extent of such protection depends largely upon the disclosure requirements adopted under a labeling policy. Labels must be conspicuous and must educate the consumer as to all ramifications of purchase from a gray marketeer. If labeling fails to inform consumers of any important differences between the authorized and unauthorized goods, some confusion and free riding will continue.<sup>156</sup> In the latter case, a labeling policy is under-protective of both trademark rights and consumer interests.

To provide broader protection against confusion and free riding, trademark owners have advocated "demarking" of the goods.<sup>157</sup> Consistent with existing provisions of both section

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155 See, e.g., N.Y. GEN. BUS. LAW § 218-aa (McKinney Supp. 1986). The New York legislation requires retailers of gray market goods to disclose lack of manufacturer warranties and rebates. The legislature limited the law to articles of personal consumption and requires point of purchase signs or labeling. In the case of mail order retailers, the law requires such disclosure in advertisements. Violations are punishable by small fines and consumer refunds or credits. The statute offers an affirmative defense if the gray marketeer provides a written warranty offering equal or greater protection than that provided by the manufacturer. *Id.*

156 For example, the recent New York legislation, *id.*, provides insufficient protections against consumer confusion and free riding. The law requires disclosure of gray market status only for consumer products and only if the products are sold without manufacturer warranties, rebates, or English instructions. *Id.* This disclosure is inadequate and ignores potential differences in quality. Full disclosure demands labeling of all trademarked goods imported or sold without the trademark owner's consent. Such a requirement ensures elimination of confusion by alerting all consumers to the unauthorized status of the goods and possible differences in quality.

The affirmative defense provided in the legislation creates administrative problems and may result in inadequate protections against confusion and free riding. If the gray marketeer offers an equal or better warranty than that offered by the manufacturer, he is not required to label or otherwise disclose the status of the goods. Enforcement of such a provision is subjective and destroys the "bright line" nature of the statute. In addition, an affirmative defense based upon warranties would not protect consumers who are denied manufacturer rebates. Thus, the affirmative defense is ill advised. A proper disclosure statute should requpon warranties would not protect consumers who are denied manufacturer rebates. Thus, the affirmative defense is ill advised. A proper disclosure statute should require labeling of all gray market goods. The gray marketeer may offer his own warranties, but this should not circumvent the labeling requirement. Consumer confusion and free riding may only be avoided by allowing consumers, in all instances, to make a fully informed choice.

157 See Riley, *supra* note 3, at 22, col. 1.

526<sup>158</sup> and the customs regulations,<sup>159</sup> this solution would allow importation of gray market goods only if the trademark is removed, covered, or otherwise obliterated. Although trademark owners claim that demarking is relatively inexpensive,<sup>160</sup> complete demarking is often impractical.<sup>161</sup> Demarking eliminates confusion and free riding, but would have the likely effect of sharply curtailing gray market imports.<sup>162</sup> Thus, a demarking policy is over-protective of trademark rights and detrimental to consumers.

Neither labeling nor complete demarking alone may be fully satisfactory. If, however, combined together under a hybrid demarking/labeling policy, a practical balancing of interests may be possible. This approach would require the parallel importer to remove or cover the trademark, but only to the extent feasible.<sup>163</sup> If such removal or covering was not practical in the judgment of the Customs Service, the importer would be required to affix appropriate labels. Hybrid demarking/labeling overcomes the objections of gray marketeers to a pure demarking requirement<sup>164</sup> and may afford greater protection to both trademark owners and consumers than labeling alone.<sup>165</sup> Such a policy solution, however, does not

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158 19 U.S.C. § 1526(c) (1982) states:

Any person dealing in any such merchandise [defined in § 526(a)] may be enjoined from dealing therein within the United States or may be required to export or destroy such merchandise or to remove or obliterate such trademark and shall be liable for the same damages and profits provided for wrongful use of a trade-mark

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159 19 C.F.R. § 133.21(c)(4) (1985) provides that importation is allowed when "[t]he objectionable mark is removed or obliterated prior to importation in such a manner as to be illegible and incapable of being reconstituted, for example by: (i) [g]rinding off imprinted trademarks wherever they appear; (ii) [r]emoving and disposing of plates bearing a trademark or tradename."

160 "COPIAT has investigated the feasibility of the demarking proposal and determined that practically all of its members' products could be demarked at low cost (a few pennies per unit) without compromising the products' physical integrity or appearance." Lexecon, *supra* note 4, at 85.

161 See Lewin, *supra* note 54, at 21-23. Lewin argues against a demarking requirement on the grounds that it would be far too expensive to cover or obliterate every trademark. Under a demarking policy, manufacturers would have every incentive to place the marks where they could not be obliterated without destroying the marketability of the product.

162 See *id.* See also Note, *supra* note 23, at 114-15.

163 See Lexecon, *supra* note 4, at 84.

164 Under the hybrid demarking/labeling solution, the marks only need to be removed to the extent feasible. This solution reduces the costs of demarking by vesting discretion in the Customs Service. As for the incentives for the manufacturer to put the trademarks in "hard to cover" areas (see note 161 *supra*), such an effort would have just the opposite effect because the manufacturer would then be only entitled to labeling.

165 A hybrid demarking/labeling policy provides greater protections against consumer confusion and free riding than provided by the recent New York legislation. See note 155 *supra*. On the other hand, if the disclosure requirements under a labeling policy were made more stringent as suggested at note 156 *supra*, the labeling policy would be preferable. The administrative simplicity of the labeling solution would outweigh the incremental protections against free riding offered under the hybrid policy.

provide a "bright line" rule. It vests discretion in the Customs Service to determine the appropriate extent of demarking for each gray market product. As a result, this approach is likely to be costly to administer, may result in different standards for every product, and could breed substantial litigation.<sup>166</sup> Thus, while such a solution may be theoretically desirable, it has several practical and administrative drawbacks.

None of the proposed options is ideal. A properly designed labeling policy, however, is the best solution available. Labeling is administratively simple and is consistent with current country of origin product marking requirements.<sup>167</sup> Labeling allows continued gray market importation and offers greater protections to trademark owners and consumers than the status quo. The effectiveness of the labeling solution depends largely upon the stringency of the labeling requirements.<sup>168</sup> To the extent that it adequately informs consumers, labeling eliminates consumer confusion and minimizes free riding. Some free riding will continue to exist, but the gray marketer will be forced to convince informed consumers that parallel imports offer a viable alternative to authorized goods. This solution properly shifts much of the burden to the gray marketer to achieve success largely as a result of his own marketing and distribution efforts rather than as a result of free riding.

## V. Conclusion

As a matter of law, section 526 of the Tariff Act of 1930 is a valid statute enacted by Congress to protect the property rights of American trademark owners by barring the importation of trademarked goods without the trademark owner's consent. Customs regulations which limit the scope of this statute are *ultra vires* to the extent that they improperly discriminate against American trademark owners who are affiliated with a foreign manufacturer. The regulations cannot be supported on the grounds of agency authority, legislative history, antitrust precedent, deference to agency interpretation, congressional acquiescence, or discretionary enforcement.

However, consideration of the policies underlying protection

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166 Trademark owners argue that "[t]here would no doubt be 'close cases' to decide regarding the appropriate extent . . . of product demarking, [but] Customs already makes product labeling decisions under country of origin marking requirements quite similar to those it would make under a demarking policy." *Lexecon*, *supra* note 4, at 90. This argument, however, understates the administrative difficulties and costs involved in analyzing the extent of demarking required for every gray market product. In addition, the discretion vested in the Customs Service under a hybrid (or demarking) standard is considerably broader than under a labeling standard.

167 See 19 U.S.C. § 1304 (1982); 19 C.F.R. § 134.32 (1985).

168 See notes 155-56 *supra* and accompanying text.

of intellectual property rights and consumer interests suggests that section 526 should not be enforced to the full extent of the law. Although trademark owners would be protected from free riding if gray market imports were barred, consumers would be denied the availability of lower priced gray market goods without any corresponding decreases in prices of authorized goods. In contrast, allowing unrestricted gray market importation under the status quo does not adequately protect trademark owners from free riding and promotes consumer deception and confusion.

The most practical solution is a stringent labeling requirement that educates consumers regarding all of the ramifications of the purchase of gray market goods. Labeling protects trademark owners by minimizing free riding, protects consumer interests by eliminating confusion, and allows the continued importation of gray market goods.

*John A. Young, Jr.*