THE GRAY MARKET AFTER *K MART*: SHOPPING FOR SOLUTIONS*

I. INTRODUCTION

Trademarks symbolize "a particular class or quality of goods as the manufacture, produce or property of the person which puts them in the general market for sale. . . ."[1] When a product earns a reputation for its quality or for the services provided by the trademark owner, goodwill adheres to the trademark, and consequently, to the trademark owner.[2] A trademark thus generates this intangible economic benefit which attaches to the trademark owner for his efforts in the marketplace. If a trademark owner's goodwill increases, then the net worth of his business increases.

Gray markets arise when either foreign or domestic third party wholesalers purchase genuine, foreign-manufactured merchandise. The products are *genuine*, not counterfeit or stolen, because they are manufactured under the authority of the domestic trademark owners for sale abroad. Even though trademark owners do not intend to sell that particular merchandise in the United States, the products bear registered American trademarks.[3]

Foreign wholesalers who purchase the genuine merchandise, however, sell the genuine merchandise back to gray marketeers in the United States without the consent of the domestic trademark owners.[4] These independent domestic retailers purchase the diverted goods[5] and sell them for a price lower than that of-

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1 The Trade-Mark Cases, 100 U.S. 82, 95 (1879). The Lanham Act defines a trademark as "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 (1988).

2 *See infra* notes 177-85 and accompanying text.

3 *See infra* notes 35-49 and accompanying text.

4 "A gray-market good is a foreign-manufactured good, bearing a valid United States trademark, that is imported without the consent of the United States trademark holder." K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 285 (1988). These markets are "gray" and not "black" because the goods imported through such markets are not counterfeit or stolen. *See* Comment, K Mart Corp. v. Cartier, Inc.: *A Black Decision for the Gray Market*, 38 AM. U.L. REV. 463, 463-64 (1989) [hereinafter *A Black Decision*].

5 Today, "diverted goods," "parallel imports," and "gray market goods" are virtually synonymous. All are genuine products that have been purchased from a foreign manufacturer by a foreign wholesaler who subsequently sells the product to an independent retailer in the United States. For the sake of simplicity, this Note will use these terms interchangeably.

fered by the trademark owners' recognized distributors. Trademark owners do not authorize these domestic dealers to sell the trademarked goods since neither party has entered into a distribution agreement with the other. Because the gray marketeers are not authorized dealers and do not incur, for example, the same overhead as the authorized distributors, they are not obligated to sell the product at an inflated cost to the consumer.[6] Gray marketeers sell the same merchandise at a lower cost, creating the problem of "intrabrand" competition with the authorized dealers.[7] Trademark owners claim that gray marketeers participate in, among other things, trademark infringement and usurpation of goodwill. Gray marketeers argue that they participate in free trade.

Statutory interpretation lies at the heart of this conflict between trademark owners and gray marketeers. In 1922, Congress passed section 526 ("section 526") as an amendment to the Tariff Act of 1922 (the "Tariff Act"),[8] to prevent foreign infringement of domestic trademarks.[9] To effectuate its policies, Congress authorized the Customs Service ("Customs"), as an agency of the Department of Treasury, to interpret and enforce any federal act governing tariff and trademark laws.[10] Customs issued section 133.21(c) ("section 133.21") of its importation regulations to effectuate section 526.[11] However, the Customs regula-

[6] One side effect of this lower price is the exclusion of manufacturers' warranties on the products. *See infra* notes 178-87 and accompanying text. *See* Note, *Emerging Gray Market Balance: A Global Perspective on Solutions for the Nineties*, 10 HASTINGS COMM/ENT L.J. 1101, 1109-12 (1988).

[7] *See* Note, *Applying Grecian Formula to International Trade*: K Mart Corp. v. Cartier, Inc. *and the Legality of Gray Market Imports*, 75 VA. L. REV. 1397, 1400 (1989) [hereinafter *Legality of Gray Market Imports*].

[8] Fordney-McCumber Tariff Act of 1922, ch. 356, § 526, 42 Stat. 858, 975 (1922), *superseded by* Tariff Act of 1930, ch. 497, § 526, 46 Stat. 590, 741 (1930) (codified at 19 U.S.C. § 1526 (1982)). "This amendment provides, in substance, that it shall be unlawful to import into the United States any merchandise if such merchandise . . . bears a trade-mark registered in the Patent Office by a person domiciled in the United States." 62 CONG. REC. S11,603 (daily ed. 1922) (statement of Sen. Moses). "[A]ll [section 526] does is prevent fraud, and . . . the Senate is in favor of protecting property rights of *American citizens who have purchased trademarks from foreigners*." *Id.* (statement of Sen. Sutherland) (emphasis added). *See infra* notes 53-57 and accompanying text.

[9] Allegedly, the drafters of section 526 were primarily concerned with preventing the importation of goods bearing registered American trademarks. *See* Note, *Grey Market Goods and Modern International Commerce: A Question of Free Trade*, 10 FORDHAM INT'L L.J. 308, 313 & n.23 (1987) [hereinafter *A Question of Free Trade*].

[10] 19 U.S.C. § 1624 (1982).

[11] T.D. 40,380, 46 Treas. Dec. 165 (1923). The original draft of the regulation prohibited the importation of goods bearing copied, simulated, or counterfeited trademarks. *Id. See* Kersner & Stein, *Judicial Construction of Section 526 and the Importation of Grey Market Goods: From Total Exclusion to Unimpeded Entry*, 11 N.C.J. INT'L L. & COM. REG. 251, 261 (1986) [hereinafter Kersner & Stein]. The regulation was not so numbered in its initial stages, but this Note will refer to it as such for purposes of clarity. Moreover,

tion, allegedly contrary to the language of the statute it was meant to enforce, permitted the importation of goods bearing genuine trademarks if such marks fell within certain categories.[12]

Domestic trademark owners contend that because the activities in which these gray marketeers participate infringe upon the rights vested in the owners, the prohibitory "plain" language of section 526 of the Tariff Act applies to gray market goods as well as to stolen or counterfeit goods.[13] The owners also maintain that because section 526 is plain on its face, section 133.21 is not a legitimate interpretation of the Tariff Act and is too expansive as applied to foreign exporters.[14] They assert that the exceptions enumerated in section 133.21 relax Customs' obligation to patrol and seize gray market goods.[15]

Conversely, proponents of the Customs regulation do not interpret the statute to ban gray market goods altogether.[16] They posit that section 133.21 carries out the narrower congressional intent embodied in section 526, the protection of domestic purchasers of foreign trademarks from third party infringement.[17] Additionally, gray market advocates suggest that what

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section 133.21(c) provides additional exceptions that will not be discussed here. This Note will focus on the exceptions set forth in section 133.21(c)(1) through (c)(3).

[12] A genuine trademarked good is merchandise that has been produced by an authorized manufacturer, as opposed to a counterfeit product, which has been made by someone not licensed to do so. *See Legality of Gray Market Imports, supra* note 7, at 1397.

[13] *See generally* Supplemental Brief for Respondents on Reargument, K Mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988) (Customs' interpretation not within scope of its administrative capacity).

[14] *Id.*

[15] Section 133.21(c) states in pertinent part:

> (c) *Restrictions not applicable.* The restrictions set forth . . . do not apply to imported articles when:
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> (1) Both the foreign and the U.S. trademark or trade name are owned by the same person or business entity;
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> (2) The foreign and domestic trademark or trade name owners are parent and subsidiary companies or are otherwise subject to common ownership or control . . . ;
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> (3) The articles of foreign manufacture bear a recorded trademark or trade name applied under authorization of the U.S. owner . . . .

19 C.F.R. § 133.21(c)(1)-(3) (1988).

[16] For example, 47th Street Photo, Inc. and K Mart Corp. are two companies that participate in the gray market. 47th Street Photo deals primarily in camera and electronic equipment, while K Mart offers a wide variety of products ranging from perfumes to cameras. Additionally, consumer groups support the preservation of the gray market because it offers customers a greater selection of products at lower prices. *See* Supplemental Brief of Amicus Curiae in Support of Petitioners on Reargument at 5 & n.3, K Mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988) [hereinafter Supplemental Brief of Petitioners].

[17] The dearth of legislative history is the cause of most of the confusion surrounding the statute. Congress allotted approximately 10 minutes for debate of the amendment in 1922 and as a result, courts spent the next 66 years attempting to divine the legislative intent. *See infra* notes 89-132 and accompanying text. At least one author has found the legislative history straightforward. "The Senate debate . . . shows that the primary mo-

trademark owners seek from their interpretation of section 526 is protection from legitimate competition. According this protection, they contend, is tantamount to granting a monopoly in the sale of those goods.[18]

As a result of these competing interpretations, a recent conflict arose among the circuits concerning two interrelated issues. First, courts disagreed on the legislative intent behind section 526.[19] Second, if such intent was actually discernable, then the question turned on whether section 133.21 adequately represented the congressional intent set forth in section 526.[20] While one circuit held that determination of the legitimacy of section 133.21 was a matter of judicial deference to agency interpretation,[21] another found that, while judicial deference may be necessary at certain times, it was not mandatory.[22] In *K Mart Corp. v. Cartier, Inc.*,[23] the Supreme Court finally intervened in an effort to both close the rift among the circuits and resolve the issue of the legitimacy of gray marketeering. The Court ultimately resolved little, electing instead to create a compromise it deemed agreeable to all parties involved.

Section II of this Note explores the rise of and statutory response to the gray market. Section III traces the judicial interpretations of the changes that occurred in the statutes. Section

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tive of the section's proponents was to protect the purchasers of German property located in the United States seized during World War I by the United States Government." *A Question of Free Trade*, *supra* note 9, at 313.

18 *See* Supplemental Brief for Petitioners, *supra* note 16, at 4-5.

19 *See infra* notes 89-132 and accompanying text.

20 Customs amended section 133.21 numerous times in an attempt to maintain a parallel representation of section 526. *See generally* Joint Appendix for Petition for Reargument, K Mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988) (letters from Customs to Congress addressing shifts in international trade and importation). Though members of Congress essayed to repeal section 526, the statute remains on the books, along with section 133.21. *Id.*

The judiciary has been less than determinative regarding the validity of the statute and regulation. Courts have appeared reluctant to intervene on behalf of trademark owners. Perhaps courts fear the repercussions involved in shutting down a constantly expanding industry. *See infra* note 231 and accompanying text. Courts have almost uniformly deferred to agency interpretation rather than interpreting the statute themselves. *See infra* notes 89-113 and accompanying text. The main thrust of most of the cases is that no one is more capable of deciphering legislative intent than the legislature itself. Therefore, it is the legislature's responsibility to lend a utile interpretation to the statute. *But see* Vivitar Corp. v. United States, 761 F.2d 1552 (Fed. Cir. 1985) (courts should decide validity of section 133.21 on a case-by-case basis), *cert. denied*, 474 U.S. 1055 (1986).

21 *Vivitar*, 761 F.2d 1552. *See infra* notes 71-77 and accompanying text.

22 Coalition to Preserve the Integrity of Am. Trademarks v. United States, 790 F.2d 903 (D.C. Cir. 1986), *aff'd*, 485 U.S. 176 (1988). The majority found that the language of section 526 did not need any further interpretation. *Id.* at 908. *See infra* notes 122-28 and accompanying text.

23 485 U.S. 176, *reargued*, 486 U.S. 281 (1988).

IV discusses the Supreme Court's failed attempt in the *K Mart* decision to ultimately resolve the issues presented by gray markets and their effects on trademark law. Part V enumerates argumentation for the proscription of the gray market. Part VI sets forth the arguments for the preservation of the gray market. In conclusion, this Note suggests a more feasible solution to the "problem" of gray markets.

II. THE DEVELOPMENT OF GRAY MARKETS

While the intangible properties of a trademark benefit a trademark owner, they also serve multiple functions for a consumer. A trademark identifies and distinguishes a product. It acts as a "guarantee" that the goods are of a particular quality, and insures that all of the goods carrying the trademark originate from a common source.[24] Additionally, if the performance and quality of the merchandise please the consumer, he will continue to purchase that product.[25]

Whether a trademark owner is a manufacturer or distributor, a trademark vests the owner with certain rights.[26] It protects the owner from infringement by other parties and represents the goodwill of the owner's business.[27] A trademark also identifies one manufacturer's product in a sea of other similar goods.[28] Thus, a trademark serves as a self-perpetuating advertisement, holding out the merchandise it represents over other similar products.[29]

A domestic trademark owner who participates in international trade subjects his product and trademark to gray markets.[30] To best exploit foreign markets, a domestic trademark owner must control the method by which he distributes his product overseas. He may either establish a foreign manufacturing division, license his trademark to a foreign manufacturer, or purchase the right to use a foreign trademark.[31] Unless contrac-

24 1 J. MCCARTHY, TRADEMARKS AND UNFAIR COMPETITION, § 4:4, at 104-05 (2d. ed. 1984) [hereinafter MCCARTHY].

25 *Id.*

26 "[The trademark] is not [a] right . . . in gross, but exist[s] only in connection with the trade in the goods on which [it] appear[s] . . . . " Brief Amicus Curiae of the United States Trademark Association, *Coalition to Preserve*, 790 F.2d 903 (D.C. Cir. 1986), *reprinted in* 77 TRADEMARK REP. 248, 252 (1988) [hereinafter USTA Brief].

27 *See infra* notes 177-85.

28 1 MCCARTHY, *supra* note 24, § 4:4, at 104.

29 *See generally id.* at § 1:1.

30 *See* Note, *The Gray Market Case: Trademark Rights v. Consumer Interests*, 61 NOTRE DAME L. REV. 838, 838-39 (1986) [hereinafter *Gray Market Case*].

31 *See infra* notes 36-38, 47-49 and accompanying text.

tually stipulated, an American trademark owner most often cannot control all sales that a foreign manufacturer or licensee makes to third parties.[32] Gray markets flourish when the retail price of trademarked merchandise sold abroad by a foreign manufacturer or licensee is less than the retail price of that merchandise sold domestically.[33] "[O]ther importers have an obvious incentive to purchase the goods abroad . . . and resell them in the United States . . . at a price below that charged by the [foreign manufacturer]."[34]

A. *The Creation and Policing of Gray Markets*

Prior to 1988, Customs Regulation section 133.21 directly addressed three scenarios which usually give rise to gray marketeering.[35] In the first scenario, an independent domestic company purchases the right to (1) register and use the foreign company's trademark and (2) sell the foreign-manufactured goods in the United States from an independent foreign company. Unless explicitly stated otherwise in a contract between the two parties, an American company has no control over the market to which a foreign company will subsequently sell the trademarked goods.[36] However, purchasing the right to use the

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32 Such control is potentially illegal under antitrust laws and will be held to a rule of reason to determine its legitimacy. *See infra* notes 215-31 and accompanying text.

33 A trademark owner often will charge more for the product in the American market than it will overseas. *See* Lipner, *The Legality of Parallel Imports: Trademark, Antitrust, or Equity?*, 19 TEXAS INT'L L.J. 553, 554 (1984) [hereinafter Lipner, *Legality of Parallel Imports*]; *A Question of Free Trade*, *supra* note 9, at 335.

34 Coalition to Preserve the Integrity of Am. Trademarks v. United States, 790 F.2d 903, 904 (D.C. Cir. 1986), *aff'd*, 485 U.S. 176 (1988). "The same result can occur, however, if the American trademark owner is the parent and the goods are manufactured abroad by a foreign subsidiary." *Id.*

35 19 C.F.R. § 133.21(c)(1)-(3) (1989). For a chart breakdown of the three scenarios which lead to gray markets and recent judicial decisions regarding the legality of the grey markets, see Smart, *Squaring the Gray Goods Circle*, 10 CARDOZO L. REV. 1963, 1979 (1989) [hereinafter Smart]. These three scenarios are not the only situations in which gray markets can arise.

> Parallel imports can involve a spectrum of corporate relationships—independent U.S. distributors having no relationship to the foreign manufacturer [or] U.S. distributors to whom U.S. trademark rights were assigned by the foreign manufacturer with reassignment rights reserved. . . . [I]n some cases the goods sold by the United States trademark owner and the parallel importer have been identical; in others they have been identical, but with different warranties or services offered; in still others the goods have been different.

USTA Brief, *supra* note 26, at 250-51 (citiations omitted). In fact, "[t]he variety of corporate relationships between these domestic companies and their foreign affiliates . . . are limited only by a corporate lawyer's imagination." Gorelick & Little, *The Case for Parallel Importation*, 11 N.C.J. INT'L L. & COM. REG. 205, 207 (1986) [hereinafter Gorelick & Little].

36 *See infra* notes 108 and 198-99 and accompanying text.

trademark and import the goods does not insure the domestic company against the possibility that the foreign company will not sell the same trademarked products to a third party distributor. If that third party subsequently imports the foreign-bought goods into the United States, parallel importation occurs, creating "intrabrand competition" between the domestic company and the third-party distributor.[37] Customs will prohibit importation of parallel goods in this scenario because there is no corporate relationship between the independent domestic company and the foreign trademark owner.[38]

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[37] For an economic perspective of the ramifications of intrabrand cartels, see generally Liebeler, *Intrabrand "Cartels" Under* GTE Sylvania, 30 U.C.L.A. L. REV. 13 (1982) [hereinafter Liebeler, *Intrabrand "Cartels"*]. Intrabrand dealer cartel arrangements should not violate section 1 of the Sherman Act. *Id.* at 19.

[38] Customs will permit importation of merchandise where the foreign and domestic trademarks are owned by "the same entity." For example, an international organization maintains an American subsidiary to manage its business stateside. The foreign manufacturer produces the merchandise and ships it to the United States for distribution while maintaining foreign distribution of the same merchandise. Section 133.21(c)(1) states in pertinent part:

> (c) *Restrictions not applicable.* The restrictions set forth . . . do not apply to imported articles when:
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> (1) Both the foreign and the United States trademark or trade name are owned by the same person or business entity . . . .

19 C.F.R. § 133.21(c)(1) (1989).

> The policy of . . . Customs . . . has been . . . that if the U.S. trademark owner and the owner of the foreign rights to the same mark are one and the same . . . , articles produced and sold abroad by the foreign owner may be imported by anyone since the trademark owner has itself either introduced or authorized the introduction of the articles into commerce and thereafter may not unreasonably restrict the use of the product.

Coalition to Preserve the Integrity of Am. Trademarks v. United States, 598 F. Supp. 844, 850 (D.D.C. 1984). *See infra* notes 191-99 and accompanying text (discussing application of the first doctrine to gray market). A parent company will, more often than not, own trademarks attributed to its subsidiaries. A parent licenses the use of a trademark to a foreign subsidiary manufacturing the product to which the trademark is to be affixed. When the foreign subsidiary manufactures and sells the trademarked good under authorization of the domestic parent, the probability exists that the subsidiary will indirectly sell to a third party infringer who will then sell the merchandise domestically at a competitive price. *See generally* Kersner & Stein, *supra* note 11.

Under the copyright "first sale" or the trademark "exhaustion" doctrines, if the domestic parent issued the trademark, it should not subsequently restrict further sales abroad. *See* Donohue, *The Use of Copyright Laws to Prevent the Importation of "Genuine Goods,"* 11 N.C.J. INT'L L. & COM. REG. 183, 192-203 (1986) [hereinafter Donohue] (grant of copyright protection statutorily protected and should be utilized to prevent gray market importation). *But see* Note, *Copyright Law—Gray Marketing—The First Sale Doctrine of Copyright Law Closes Another Avenue of Redress*, 34 VILL. L. REV. 597 (1989) [hereinafter *First Sale Doctrine*] (copyright laws may not be utilized to prevent gray market importation). *See infra* notes 204-14 and accompanying text. This exception was most probably aimed at international enterprise because, as seen in later legislation, Congress did not wish to extend trademark protection to international concerns attempting to corner the market. "In 1954, Congress was presented with a bill which would have made section 526 inapplicable when the U.S. trademark owner was affiliated . . . with the foreign manufacturer." *Gray Market Case, supra* note 30, at 842 n.17. *See also Hearings on H.R. 9476 Before the House Comm. on Ways & Means*, 83rd Cong., 2d Sess. 9 (1954). "The Celler Bill . . . did attempt to remove import protection for related companies, . . . but as

In the second scenario, a domestic company registers the trademark of an *affiliated* foreign manufacturer. There are three methods by which a domestic company can become affiliated with a foreign manufacturer. In all three types of affiliation, parallel importation occurs when third parties purchase goods intended for foreign sale and export them back into the United States. Only in the first and second types of affiliation do the goods produced bear registered United States trademarks.

In the first method of affiliation, the foreign manufacturer establishes a domestic *shell* subsidiary[39] in the United States. The shell company utilizes the same trademark as the foreign parent and registers the foreign trademark with the United States Patent and Trademark Office. Customs will not prevent parallel importation of these trademarked goods because the foreign parent governs the domestic shell subsidiary and therefore, the two companies fall within the "common control" exception in section 133.21.[40]

The second type of affiliation occurs when a domestic company establishes a foreign manufacturing subsidiary. The American company can incorporate its foreign manufacturing facility to protect itself under foreign laws and insure that the foreign subsidiary maintains autonomy. If it can show corporate independence, the domestic company protects itself against the "common control" exception set forth in section 133.21(c)(2).[41]

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of mid-1969, no legislation affecting . . . Section . . . 526 . . . has been passed." Atwood, *Import Restrictions on Trademarked Merchandise—the Role of the United States Bureau of Customs*, 59 TRADEMARK REP. 301, 307 (1969) [hereinafter Atwood]. This policy is particularly attractive when applied to international concerns which have subsidiaries in different countries. The parent establishes foreign manufacturing divisions to take advantage of potentially lower production costs and to exploit foreign markets.

39 Smart, *supra* note 35, at 1965-66.

40 19 C.F.R. § 133.21(c)(2) which reads in pertinent part:

> (c) *Restrictions not applicable*. The restrictions set forth . . . *do not apply* to imported articles when:
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> . . . .
>
> (2) The foreign and domestic trademark or trade name owners are parent and subsidiary companies *or are otherwise subject to common ownership or control* . . . .

Id. (emphasis added). *See* United States v. Eighty-Nine (89) Bottles of "Eau de Joy," 797 F.2d 767 (9th Cir. 1986) (because foreign manufacturer and domestic trademark owner were not subject to common control, importation of genuine goods bearing domestic trademark prohibited).

41 Additionally, as long as the domestic company has registered its trademark with the countries in which it is doing business, it can enjoy trademark protection under their foreign laws. *See* International Convention for the Protection of Industrial Property, Paris Union Treaty of 1934, art. 4, 53 Stat. 1748, T.S. 941; 4 R. CALLMANN, UNFAIR COMPETITION, TRADEMARKS, AND MONOPOLIES § 23.04, at 14-16 (4th ed. 1983) [hereinafter CALLMANN]. "[T]he same trademark has a different legal existence in each country where it is registered, and the mark symbolizes the *local* goodwill that the domestic mark

In the third method of affiliation, a domestic company establishes an *unincorporated* manufacturing division abroad.[42] This is not the most strategic of alternatives for a corporation seeking to protect itself from the "common control" exception of section 133.21.[43] If the foreign subsidiary is not incorporated under the laws of the country in which it is located, then United States courts may pierce the corporate veil and presume domestic parent control over the foreign subsidiary.[44] In a gray marketeering action, courts will focus on the foreign subsidiary's dependency on the domestic corporation.[45] As a result, courts will conclude that the trademark at issue is ultimately subject to the control of the domestic parent company.[46] Therefore, these trademarked goods fall within the "common control" exceptions established by Customs.

The third gray market scenario arises when a domestic trademark holder *authorizes* an independent foreign manufacturer to use a domestic trademark through a licensing agreement.[47] By establishing contractual relations with foreign concerns, the domestic trademark holder seeks to increase sales abroad or in particular geographic regions.[48] However, once that foreign manufacturer sells to a third party, there are no assurances from

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owner has generated." Krumholtz, *The United States Customs Service's Approach to the Gray Market: Does It Infringe On the Purposes of Trademark Protection?*, 8 J. COMP. BUS. & CAP. MARKET L. 101, 107 (1986) [hereinafter Krumholtz].

42 Smart, *supra* note 35, at 1965-66.

43 *See supra* note 40.

44 *Cf.* United States v. Guerlain, Inc., 155 F. Supp. 77, 80 (S.D.N.Y. 1957), *vacated and remanded*, 358 U.S. 915 (1958), *dismissed*, 172 F. Supp. 107 (S.D.N.Y. 1959).

45 *A Question of Free Trade*, *supra* note 9, at 326 ("the fact that a foreign corporation establishes a local subsidiary should not obscure the economic reality of interdependence between the local entity and the foreign entity").

46 "This is not to say that [Customs] does, or will, or should, pierce corporate veils where representations are made that the American firm . . . is independent from foreign control." Atwood, *supra* note 38, at 306.

47 Section 133.21(c)(3) states in pertinent part:

> c) *Restrictions not applicable.* The restrictions set forth . . . *do not apply* to imported articles when:
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> . . . .
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> (3) The articles of foreign manufacture bear a recorded trademark or trade name applied *under authorization of the U.S. owner* . . . .

19 C.F.R. § 133.21(c)(3) (1989) (emphasis added). *See, e.g.*, Disenos Artisticos E Industriales, S.A. v. Work, 676 F. Supp. 1254 (E.D.N.Y. 1987) (notwithstanding section 133.21(c)(3), unauthorized importer may be held accountable under section 526); Premier Dental Products Co. v. Darby Dental Supply Co., 794 F.2d 850 (3d Cir.), *cert. denied*, 479 U.S. 950 (1986) (injunction granted against unauthorized third party distributor of trademarked dental supplies pursuant to section 526(a)). *But see* El Greco Leather Prod. Co., Inc. v. Shoe World, Inc., 599 F. Supp. 1380 (E.D.N.Y. 1984), *rev'd*, 806 F.2d 392 (2d Cir. 1986), *cert. denied*, 484 U.S. 817 (1987) (requirement of written consent of trademark owner not applicable to protect products rejected by the owner).

48 K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 286-87 (1988).

the foreign third party that the goods will not be subsequently imported to the United States.[49]

B. *Developments in Statutory Protection for Trademark Owners*

By the turn of this century, American international trade expanded because domestic and foreign manufacturing capacity increased. American concerns, realizing their greater commercial potential, sought to keep that potential, profit, and growing resultant goodwill within American borders.[50] Congress enacted the Trade-Mark Act of 1905[51] to offer domestic trademark holders federal protection for their products and profits. However, the Trade-Mark Act only protected American manufacturers from the threat of copies or simulations of American goods.[52] The Act did not cover incidents of parallel importation of genuine goods.

When a trademark infringement suit resulting from parallel importation finally arose, Congress was not able to combat the problem effectively. In a hurried debate, Congress elected to apply tariff laws to patrol the burgeoning gray market, enacting section 526 to amend the Tariff Act of 1922.[53] The amendment

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49 *Id.* This presumes the absence of complex contractual arrangements limiting or prohibiting the foreign company's sales to third parties outside particular geographic regions.

50 Cohen, *Grey Market Imports and the International Location of Manufacturing*, 11 N.C.J. INT'L L. & COM. REG. 171, 176 (1986) [hereinafter Cohen].

51 Ch. 592, § 27, 33 Stat. 724 (1905) (current version at 15 U.S.C. § 1124 (1988)).

52 "[N]o article of imported merchandise . . . *which shall copy or simulate a trade-mark registered in accordance with the provisions of this Act* . . . shall be admitted to entry at any custom-house of the United States." Trade-Mark Act of 1905, ch. 592, § 27, 33 Stat. 730 (1905) (emphasis added). *See* Customs Regs., art. 475 (1923). Article 475 which reads in relevant part:

> Entry is prohibited by imported merchandise which shall copy or simulate the name of any domestic manufacture or manufacturer . . . or of any manufacturer . . . located in any foreign country which . . . affords similar privileges to citizens of the United States, . . . or which shall bear a name or mark calculated to induce the public to believe that the article is manufactured in the United States . . . .

Id.

53 Ch. 356, § 526, 42 Stat. 975 (1930) (codified at 19 U.S.C. § 1526 (1988)). The bill was a response to the Second Circuit's decision in A. Bourjois & Co. v. Katzel, 275 F. 539 (2d Cir. 1921), *petition for reh'g denied*, 275 F. 544, *rev'd*, 260 U.S. 689 (1923). The Congressional Record is replete with inferences that the Senate was neither clear about its definition of genuine goods nor comprehended the ramifications of the potential of the gray market. *See* 62 CONG. REC. S11,602-05 (daily ed. 1922) ("[The amendment] has no place . . . in a tariff bill. It is a matter particularly of international relations, bearing upon our international treaty and trade-mark conventions. . . .") (statement of Sen. Moses). *See* H.R. CONF. REP. No. 1223, 67th Cong., 2d Sess. 158 (1922), which reads in part:

> 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 [United States] merchandise . . . , if the imported merchandise is genuine and

initially extended protection to domestic businesses that had purchased foreign trademarks for domestic use.[54]

The following year, under the auspices of the Department of Treasury, Customs issued regulations governing the application of section 526.[55] Customs drafted a regulation identical to section 526 which did not recognize any conflict in the language of the statute. Since "[o]riginally, the content of the regulations and section 526 were identical[,] . . . [t]he 1923 regulations

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> if there is no fraud on the public. The Senate amendment makes such importation unlawful without the consent of the owner of the American trademark, 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.

Id.

The gray market has subsequently developed into a massive domestic industry. *See* K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 312 (1988); Note, *The Use of Copyright Law to Block the Importation of Gray-Market Goods: The Black and White of it All*, 23 LOY. L.A.L. REV. 645, 646 (1990) [hereinafter *The Black and White of it All*]; Note, *Grey Market Imports: A Genuine Problem for the United States Trademark Owners, Customs Service, and Courts*, 7 NW. J. INT'L L. & BUS. 762, 762 (1986) [hereinafter *Grey Market Imports*].

54 *See* Nolan-Haley, *The Competitive Process and Gray Market Goods*, 5 N.Y.L.J. INT'L & COMP. L. 231, 242 (1984) [hereinafter Nolan-Haley].

> Although the legislative history of [section 526] is meager, it does show that section 526 was enacted in large part to overrule the court of appeals' decision in *Bourjois* and to protect United States purchasers of trademarks from fraud or breach of contract by foreign sellers against whom contract remedies might be ineffective.

Id.

The real reason for congressional action may be found by examining the events of the day. By 1922, the United States had been through one world war. The United States entered a period of newfound wealth and those who grew rich wanted to keep it that way. "In the 1920s Congress was protectionist. It is doubtful that the Congress that originally passed section 526 in 1922 intended to favor foreign manufacturers over U.S. manufacturers." Cohen, *supra* note 50, at 181.

Additionally, as a result of Germany's defeat, American corporations purchased certain German trademarks. The Alien Property Custodian Act sought to safeguard those American purchases with statutory language. *See A Question of Free Trade*, *supra* note 9, at 313 (citing 62 CONG. REC. S11,604 (daily ed. 1922)). *See also* Atwood, *supra* note 38, at 303. "Up to this point, trademarks were considered in their classic sense as legitimately indicating source of origin or producer." *Id.*

Opponents debate the congressional intent behind the section 526. Trademark owners contend that, in its haste to amend the Tariff Act, Congress drafted section 526 without fully explaining its motive behind the statute's amendment and application. The overly protectionist plain language of the amendment appeared to conflict with the narrower congressional intent. Gray market proponents, on the other hand, found the legislative history clear. "Congress enacted Section 526 for the specific purpose 'of protecting the property rights of American citizens who have purchased trademarks from foreigners.'" Supplemental Brief for Petitioners, *supra* note 16, at 7 (quoting 62 CONG. REC. S11,603 (daily ed. 1922) (statement of Sen. Sutherland)).

Hindsight is an inherent problem with attempting to interpret section 526. Because section 526 was relegated only a ten-minute debate on the floor of the Senate, *K Mart*, 486 U.S. at 303, one can only speculate about congressional intent in 1922. The statute's fate should not be determined by a revisionist judiciary's view of legislative history, but by Congress in an amendment to the statute.

55 Cust. Reg. art. 476 (1923). *See supra* note 11 and accompanying text.

merely restated section 526's ban on the importation of foreign goods bearing a trademark registered in the United States."[56]

Eight years later, Congress redrafted the Tariff Act of 1922, reenacting, without change, section 526 in the Tariff Act of 1930.[57] In response to the reenactment, Customs issued Article 518(a), a precursor to section 133.21.[58] Article 518(a) barred importation of goods only when such goods bore a foreign trademark or trade name purchased by a domestic party.[59] Again, similarities between trademarks and products were not enough to prohibit entry.[60] Moreover, the regulation prohibited the entry of any goods with genuine trademarks only if and when the domestic trademark owners did not consent to the entry.[61]

Five years later, however, Customs qualified Article 518(a).[62] In effect, this regulation shifted the emphasis away from the manufacture and importation of genuine goods because "[g]oods possessing both a foreign and domestic trademark could be imported if both trademarks were owned by the same person . . . or corporation."[63] The adaptation aligned Customs' prohibition of importation more closely with the requirements established by the Trade-Mark Act of 1905.[64]

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56 Note, *Attention Gray Market Shoppers:* K Mart Corp. v. Cartier, Inc. *Fails to Clarify the Clouded Area of Gray Market Goods*, 38 CATH. U.L. REV. 933, 945 (1989) [hereinafter *Clouded Area*].

57 Hawley-Smoot Tariff Act of 1930, ch. 497, § 526, 46 Stat. 590 (1930) (codified at 19 U.S.C. § 1526 (1988)).

> The reenactment followed an unsuccessful effort to amend the statute by deleting the clause permitting an American trademark owner to consent to the admission of goods bearing its trademark into the country. That effort was designed to protect American jobs by preventing U.S. manufacturers from establishing foreign-based plants.

Coalition to Preserve the Integrity of Am. Trademarks v. United States, 790 F.2d 903, 912 (D.C. Cir. 1986) (citations omitted), *aff'd*, 485 U.S. 176 (1988).

58 T.D. 48,537, Cust. Regs. art. 518(a) (1931).

59 *Id.* The language was again identical to the unrevised section 526.

60 T.D. 48,537, Cust. Regs. art. 518(a) (1931) (superseded 1936). *See* Atwood, *supra* note 38, at 303.

61 *See* Sturges v. Clark D. Pease, Inc., 48 F.2d 1035, 1037 (S.D.N.Y. 1931) (merchandise imported for personal use nonetheless subject to section 526 sanctions because of risk of ultimate sale).

62 T.D. 48,537, 70 Treas. Dec. 336 (1936).

63 *Clouded Area*, *supra* note 56, at 945.

64 In 1946, Congress enacted the Lanham Trademark Act ("Lanham Act"). 15 U.S.C. § 1124 (1982). Rooted in the Trade-Mark Act of 1905, section 1124 of the Lanham Act "prohibit[ed] the importation of goods bearing marks that 'cop[ied] or simulate[d]' U.S. trademarks." K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 290 n.3 (1988). Section 1124 reads:

> Except as provided in subsection (d) of section . . . 526 . . . , no article of imported merchandise *which shall copy or simulate the name of* . . . *any domestic manufacture, or manufacturer*, or trader, or of any manufacturer or trader located in any foreign country which, by treaty, convention, or law affords similar privileges to citizens of the United States, or which shall copy or simulate

By the early 1950s, Customs again relaxed its import prohibitions. Under the 1936 regulations, Customs had allowed "the importation of genuine goods if the foreign trademark and the United States trademark were '*owned by the same person, partnership, association or corporation.*' "[65] Now, Customs allowed importation where the foreign trademark was held by a "related company" of the domestic owner.[66] In 1959, while a major international trademark case was pending before the Supreme Court,[67] the Justice Department pressured Customs to modify its position on gray marketeering.[68] The agency once again amended its regulations to delete the reference to "related company," returning to the language of the 1931 amendment.[69] In

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> a trademark registered in accordance with the provisions of this chapter or shall bear a name or mark calculated to induce the public to believe that the article is manufactured in the United States, . . . shall be admitted to entry at any customhouse of the United States. . . .

15 U.S.C. § 1124 (1982).

Congress constructed this section of the Act to prevent the likelihood of confusion when a consumer was faced with two similar products with two similar marks. *See, e.g.*, International Armament Corp. v. Matra Manurhin Int'l, Inc., 630 F. Supp. 741 (E.D. Va. 1986) (United States assignee of "Walther" weapons exclusive distributorship entitled to relief preventing importation of "Manurhin-Walther" weapons where defendant's and plaintiff's trademarks were similar enough to cause consumer confusion). *But see* Weil Ceramics & Glass, Inc. v. Dash, 618 F. Supp. 700 (D.N.J. 1984), *rev'd*, 878 F.2d 659, 672 (3d Cir.), *cert. denied*, 110 S. Ct. 156 (1989) (Lanham Act not applicable where goods were genuine and no consumer confusion existed).

While section 526 had only reached United States citizens, corporations, and associations, Lanham Act coverage extended to a wider class of registrants, including foreign manufacturers. Callman, *Unfair Competition with Imported Trademarked Goods*, 43 VA. L. REV. 323, 325 (1957). Yet, even the revised statute failed to address the issue of parallel importation.

65 *See Grey Market Imports*, *supra* note 53, at 767.

66 19 C.F.R. § 11.14 (1953); T.D. 53,399, 88 Treas. Dec. 383-84 (1953). Section 1124 of the Lanham Act defines "related company" and includes licensees and other affiliated companies.

67 United States v. Guerlain, Inc., 155 F. Supp. 77 (S.D.N.Y. 1957), *vacated and remanded*, 358 U.S. 915 (1958), *dismissed*, 172 F. Supp. 107 (S.D.N.Y. 1959). Customs responded to the pressures applied by the *Guerlain* court by simply deleting the exception to "related companies." Genuine goods subject to common control were prohibited from entry. 19 C.F.R. § 11.14 (1953) (incorporated into section 133.21 in 1969), T.D. 54,932, 94 Treas. Dec. 433.34 (1959). "There is no evidence that this amendment reflected a substantive change in Customs' policy, . . . since the amendment retained the limitation based on ownership of the foreign and domestic trademark by the same person, partnership, association, or corporation." Vivitar Corp. v. United States, 593 F. Supp. 420, 430 (Ct. Int'l Trade 1984). For a brief but thorough history of the statutory changes during the 1940s and 1950s, see Coalition to Preserve the Integrity of Am. Trademarks v. United States, 790 F.2d 903, 914-15 (D.C. Cir. 1986).

68 *See infra* notes 93-97.

69 T.D. 54,932, 94 Treas. Dec. 433-34 (1959). In 1968, certain members of Congress attempted to repeal section 526(a) and section 133.21. S. 3713, 90th Cong., 2d. Sess., 114 CONG. REC. S19,446 (1968). "The bill . . . exempt[ed], from trademark restrictions, articles imported for personal use, within limits of types and quantities determined by the Secretary of the Treasury." Atwood, *supra* note 38, at 320. *See* Note, *The Gray Market Controversy and the Court: An Analysis of Conflicting Court of Appeals Decisions on the Validity of Customs Regulations Permitting Unauthorized Third Party Importation of Trademarked Goods*, 18

1972, Customs executed its final version of section 133.21.[70] As a result, Customs prohibited importation of genuine goods except in the three scenarios set forth in section 133.21(c).

III. Gray Market Case History and Interpretation

A. *Judicial Deference to Administrative Interpretation*

Unfortunately, legislatures often may draft ambiguously worded statutes which, when implemented, yield more confusion than useful application. According to the canons of administrative law and traditional statutory analysis, if a statute is ambiguously worded, then the administrative agency responsible for effectuating and enforcing the statute shall reasonably interpret it.[71] However, courts are barred from interpreting statutory language that is "plain on its face."[72] Such interpretation is deemed to infringe upon the role of the legislature in the lawmaking pro-

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SETON HALL L. REV. 55, 75 (1988) [hereinafter *Gray Market Controversy*]. A host of lawsuits in the mid-1980s again shone light on section 133.21. Most of these cases questioned the propriety of Customs' interpretation of section 526 and have sought the repeal of the Customs' regulation. *See infra* notes 98-159 and accompanying text.

Additionally, trademark owners claim that the Lanham Act protects them from parallel importation. Under section 1124 of the Lanham Act, a plaintiff must prove (1) irreparable harm to his business, (2) customer confusion regarding his product and the alleged infringing product, and (3) damage to his reputation. *See* Osawa & Co. v. B & H Photo, 589 F. Supp. 1163, 1168-70 (S.D.N.Y. 1984) (trademark owner had satisfied Lanham Act preliminary injunction test, and enjoined gray marketeers from purchasing trademarked goods abroad). *But see generally* Bell & Howell: Mamiya Co. v. Masel Supply Co., 548 F. Supp. 1063 (E.D.N.Y. 1982), *vacated on other grounds*, 719 F.2d 42 (2d. Cir. 1983) (trademark owner failed to show that parallel importation of its products threatened irreparable harm to its business). *See also* Parfums Stern, Inc. v. United States Customs Service, 575 F. Supp. 416 (S.D. Fla. 1983) (trademark owner would not suffer irreparable harm from importation of gray market goods because no consumer confusion resulted).

Even copyright infringers have fallen under the rubric of the gray market. *See* W. Goebel Porzellanfabrik v. Action Indus. Inc. 589 F. Supp. 763 (S.D.N.Y. 1984) (manufacturer of copyrighted figures brought action for trade and copyright infringement against unauthorized importer).

[70] *See supra* note 15.

[71] B. SCHWARTZ, ADMINISTRATIVE LAW § 11, at 31-33 (1984). Under such traditional analysis, if no glaring discrepancy exists between the legislative intent and the agency interpretation, then a court will uphold the agency's interpretation. First, it must look at the specific language of the statute to determine whether the language is plain on its face. If the language is not plain on its face, the court must determine its intent. It then compares the language of the agency regulation with its interpretation to ascertain whether the agency interpretation is reasonable. If a discrepancy does exist, a court will then look to the rest of the statute and its surrounding circumstances to verify the legislative intent behind the statute. "If the statute is silent or ambiguous with respect to the *specific* issue addressed by the regulation, the question becomes whether the agency regulation is a permissible construction of the statute." K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 291-92 (1988) (emphasis added). *See* Production Workers Union of Chicago and Vicinity, Local 707 v. N.L.R.B., 793 F.2d 323 (D.C. Cir. 1986) (when congressional intent is clear, courts must give effect to intent of Congress regardless of agency's opinion). *See infra* notes 89-159 and accompanying text.

[72] *See generally* Pfizer, Inc. v. Heckler, 735 F.2d 1502 (D.C. Cir. 1984); Haig v. Agee,

cess.[73] In the event of a conflict between the statutory language and the administrative interpretation of that statute, judicial intervention is necessary, although such intervention may result in myriad interpretations of one statute.[74]

Most of the problems regarding sections 526 and 133.21 have sprung from the questionable ambiguity of the language of section 526 as it applies to gray market goods.[75] Courts have not been able to formulate any strict constuction of section 526 using this traditional statutory analysis.[76] In fact, over the past sixty-eight years, courts have spent most of their time debating whether the language of section 526 is ambiguous at all.[77]

B. *Case History: The First 100 Years*

In one of the earlier American trademark infringement cases, *Apollinaris Co. v. Scherer*,[78] the Southern District of New York attempted to replace the contemporary notion of trademark territoriality by establishing the concept of "trademark universality."[79] The theory of territoriality was based upon the idea that trademarks were created according to, cultivated by, and ultimately protected under the laws of particular sovereignties.[80] Under the theory of trademark universality, "a product bearing a genuine and lawfully affixed trademark [could] carry that mark anywhere in the world without infringing upon the rights of another owner of the same mark in another country."[81] The *Apollinaris* court reasoned that it really made no difference who the

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453 U.S. 280 (1981). The irony lies in the fact that for a court to determine whether a statute is plain on its face, it must interpret the statutory language.

[73] *See generally* Ohio v. Rucklehaus, 776 F.2d 1333 (6th Cir. 1985), *cert. denied*, 476 U.S. 1169 (1986) (if Congress has not spoken precisely on issue through statute, then court must uphold agency construction unless unreasonable).

[74] *Id. See Pfizer*, 735 F.2d at 1509 ("[U]nder settled principles of statutory and rule construction, a court may defer to administrative interpretations of a statute . . . *only* when the plain meaning of the rule itself is doubtful or ambiguous. . . ."); Western Oil and Gas Ass'n v. United States Environmental Protection Agency, 767 F.2d 603, 606 (9th Cir. 1985) ("[T]he courts, however, are the final authorities on issues of statutory construction, and we must reject administrative interpretations of a statute that . . . frustrate the policy that Congress sought to implement.").

[75] Because section 133.21 is the Customs mechanism to implement section 526, the regulation bears the brunt of the attack on the alleged ambiguity inherent in the statute.

[76] *See infra* notes 89-132 and accompanying text.

[77] *Id.*

[78] 27 F. 18 (C.C.S.D.N.Y. 1886).

[79] *Id.* at 21.

[80] *See* Coalition to Preserve the Integrity of Am. Trademarks v. United States, 790 F.2d 903, 909 (D.C. Cir. 1986), *aff'd*, 480 U.S. 176 (1988). Territoriality is the standard applied today. If X Corporation, incorporated and domiciled in the United States, holds a United States trademark for its widgets, that trademark is governed solely by United States law. *See* Krumholtz, *supra* note 41, at 102-04.

[81] Krumholtz, *supra* note 41, at 104.

original owner of the trademark was, so long as the good was that which the purchaser intended to buy.[82]

When this issue of gray marketeering arose before the Second Circuit in *A. Bourjois & Co. v. Katzel*,[83] the court could not offer the aegis of "territorial" trademark law to a domestic plaintiff who had slipped between the cracks of the Trade-Mark Act when he purchased a foreign trademark.[84] Faced with limited precedent,[85] the Second Circuit reversed the district court's preliminary injunction against the third-party importer.[86] The imported products were genuine, not "copied or simulated" and thus were not subject to the strictures imposed by the Trade-Mark Act.[87] Under the "universality" theory of the day, the domestic trademark owner had no means of recovery against the foreign manufacturer who had sold the trademarked goods to the third-party importer.[88]

The Supreme Court reversed the Second Circuit decision in *Katzel* the year following the congressional amendment to the Tariff Act of 1922.[89] Abandoning the "universality" theory of the previous two decades, the Court reinstated the "territorial-

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82 *Apollinaris*, 27 F. at 21. *See* Nolan-Haley, *supra* note 54, at 242. "[T]he trademark rights of the American owner [were not infringed] since the goods came from the same foreign source." *Id.*

83 275 F. 539 (2d Cir. 1921), *petition for reh'g denied*, 275 F. 544, *rev'd*, 260 U.S. 689 (1923). Five years earlier, the Second Circuit in *Fred Gretsch Mfg. Co. v. Schoening*, 238 F. 780 (2d Cir. 1916), had tested the eleven year-old Trade-Mark Act and held that no infringement occurred by the importation of genuine goods because the Trade-Mark Act only spoke to the importation of merchandise which copied or simulated a registered trademark. *Id.* at 782. *Gretsch*, however, did not alter the theory of universality. The doctrine was the courts' only parameter through the arrival of *Katzel*.

The Second Circuit ruling in *Katzel* also employed the "universality" doctrine. "The question is whether the defendant has not the right to sell this article under the trade-marks which *truly indicate its origin*. We think she has." *Katzel*, 275 F. at 540 (emphasis added).

84 The plaintiff in *Katzel* had arranged with the independent foreign corporate defendant to purchase the defendant's United States trademark and import JAVA facial powder. The plaintiff then registered the trademark with the Patent and Trademark Office. The foreign corporation continued to sell its products directly to another domestic importer, who subsequently created intrabrand competition for the plaintiff. The plaintiff could not seek protection under the Trade-Mark Act because the goods diverted by the second importer were genuine, not "copied or simulated." *Katzel*, 275 F. at 543.

85 *See, e.g.*, Menendez v. Holt, 128 U.S. 514, 523 (1888) ("The intentional use of another's trade-mark is a fraud, and when the excuse is that the owner permitted such use, that excuse is disposed of by affirmative action to put a stop to it."); The LePage Co. v. Russia Cement Co., 51 F. 941 (1st Cir. 1892) (infringement action against competitor glue company to estop defendant from using trademark plaintiff had discarded); Wertheimer v. Batcheller Importing Co., 185 F. 850 (C.C.S.D.N.Y. 1911) (common word, when used as part of recognized name or title, is subject to federal trademark protection).

86 *Katzel*, 275 F. at 543.

87 *Id.*

88 *See supra* notes 79-82 and accompanying text.

89 260 U.S. 689 (1923).

ity" approach.[90] Once a domestic trademark owner purchased a foreign mark, he enjoyed the protection of federal law because the trademark had been "recreated" in the United States. Citing *Katzel* the following year in *Prestonettes v. Coty, Inc.*,[91] Justice Holmes interpreted the *Katzel* Court's actions to constitute protection for the domestic trademark owner's "reputation" and resultant goodwill.[92]

In 1958, the Supreme Court heard *Guerlain, Inc. v. United States*.[93] Guerlain, a New York corporation, closely associated with a French perfume corporation,[94] sought to enforce section 526 against parallel importation of its products.[95] Combining "territoriality" and antitrust theories, the Southern District Court of New York ruled against Guerlain, asserting that foreign companies could not manipulate domestic trademark laws to further monopolistic ends.[96] The Supreme Court vacated and remanded the decision to the district court, which in turn dismissed the case.[97]

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90 The Court reasoned that there *was* a difference between a domestic trademark and a foreign trademark. *Id.* at 692. Once an American had purchased the right to use the foreign trademark domestically, the Trade-Mark Act of 1905 made illegal any subsequent importation of the manufactured foreign goods bearing that trademark to America. *Id.* (citing Boesch v. Graff, 133 U.S. 697 (1890)). *See* A. Bourjois & Co. v. Aldridge, 263 U.S. 675 (1923), *answering questions certified at*, 292 F. 1013 (2d Cir. 1922) (importation of French product identical to product manufactured and trademarked in the United States prohibited); Coty, Inc. v. LeBlume Export Co., 292 F. 264, 268-69 (2d Cir. 1923) ("[s]ection 526 . . . of the Tariff Act of 1922 . . . was intended only to supply the cassus omissus . . . supposed to exist . . . because of the decision of the Circuit Court of Appeals in Bourjois v. Katzel"); Note, *The Graying of American Trademarks: The Genuine Goods Exclusion Act and the Incongruity of Customs Regulation 19 C.F.R. § 133.21*, 54 FORDHAM L. REV. 83, 90 (1985).

For an explanation of how courts dealt with trademark infringement and resales, see Sturges v. Clark D. Pease, Inc., 48 F.2d 1035, 1036 (2d Cir. 1931). A domestic purchaser attempted to import a trademarked automobile for her own personal use and was refused permission by the trademark owner; refusal was upheld "on the ground that under [19 U.S.C. §§ 141-143 (1930) (later incorporated into the Customs Bureau regulations)], it was unlawful to import the automobile without written consent of [the trademark owner], because the latter had registered and filed the trade-mark which the car bore." *Id.* at 1036. *See Gray Market Controversy*, *supra* note 69, at 71.

91 264 U.S. 359 (1924).

92 *Id.* at 368. "A trade-mark only gives the right to prohibit the use of it so far as to protect the owner's good will against the sale of another's product as his." *Id.* (citation omitted).

93 155 F. Supp. 77, 80 (S.D.N.Y. 1957), *vacated and remanded*, 358 U.S. 915 (1958), *dismissed*, 172 F. Supp. 107 (S.D.N.Y. 1959).

94 155 F. Supp. at 79.

95 *Id.*

96 *Id.* at 90-91.

97 358 U.S. 915 (1958), *dismissed*, 172 F. Supp. 107 (S.D.N.Y. 1959). "[T]he Government asked that the judgment be vacated and the case remanded . . . so that the Government could move to dismiss its own case in order that legislation restricting section 526 could be promptly submitted." Coalition to Preserve the Integrity of Am. Trademarks v. United States, 598 F. Supp. 844, 849-50 (D.D.C. 1984).

Courts were relatively quiet until 1984, when a flurry of lawsuits against gray marketeers arose.[98] The plaintiff in *Osawa & Co. v. B & H Photo*,[99] a Japanese camera manufacturer with an American subsidiary, sought to enjoin gray marketeers from "independently importing and selling MAMIYA cameras."[100] The District Court for the Southern District of New York granted a preliminary injunction under the Lanham Act because the plaintiff showed irreparable harm and "sufficiently serious questions going to the merits."[101] The district court cited many arguments to substantiate granting the injunction, but eventually held public policy to be the prevailing consideration.[102]

In *Vivitar Corp. v. United States*,[103] Vivitar, Inc., a domestic corporation with limited manufacturing capabilities, licensed independent Asian manufacturers to produce and sell its goods abroad.[104] As a result of the foreign manufacturing, unauthorized wholesalers acquired and imported the Vivitar cameras.[105] Vivitar sued the United States, for failure of the United States Customs service to stop entry of these goods, claiming that section 526 provided it with an "unqualified right" to exclude unauthorized goods carrying its trademark from entering the country.[106] Vivitar also asserted that the initial authorization by the domestic trademark owner to produce the goods overseas was not a material fact in the case.[107] Customs responded that its interpretation of section 526 allowed it to refuse trademark owners the right to exclude foreign-manufactured, trademarked goods.[108]

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[98] The strength of the American dollar abroad was one reason for the surge in claims against gray marketeers. With the American dollar strong, importers could purchase more trademarked merchandise abroad, where foreign currency was weaker. *See* Gorelick & Little, *supra* note 35, at 206; Nolan-Haley, *supra* note 54, at 232.

[99] 589 F. Supp. 1163 (S.D.N.Y. 1984). Osawa & Co. is an American subsidiary of a Japanese concern, incorporated in Delaware. *Id.* at 1164.

[100] *A Question of Free Trade*, *supra* note 9, at 317.

[101] *Osawa*, 589 F. Supp. at 1165 (quoting Jackson Dairy, Inc. v. H.P. Hood & Sons, Inc., 596 F.2d 70, 72 (2d Cir. 1979)).

[102] *Id.* at 1174, 1177-78.

[103] 593 F. Supp. 420 (Ct. Int'l Trade 1984), *aff'd*, 761 F.2d 1552 (Fed. Cir. 1985), *cert. denied*, 474 U.S. 1055 (1986).

[104] *Vivitar*, 593 F. Supp. at 422-23.

[105] Foreign manufacturers sold those goods to foreign retailers or wholesalers for the foreign markets with Vivitar's authorization. *Id.* at 423. The wholesalers subsequently either resold the goods abroad or exported them to the United States without Vivitar's authorization. *Id.* When Vivitar requested that Customs take action against this gray market importing, Customs failed to respond to Vivatar's request, continuing to allow the importation of Vivitar's own products. *Id.* at 423-24.

[106] *Id.* at 425.

[107] *Id.* at 424.

[108] *Id.* at 423. Nowhere in its legislative history or statutory language does the Tariff

To determine the validity of the plaintiff's claim, the Court of International Trade ("CIT") looked at Customs' interpretation of the legislative history of section 526.[109] The court found ample proof in the legislative record to show that Congress approved of and acquiesced to the agency's interpretations.[110] It held that while the agency's interpretation may have been slightly inconsistent, it was subject only to a standard of *reasonableness* and Customs had met that standard.[111] On appeal, the Federal Circuit agreed with and upheld the CIT's standard of reasonableness.[112] However, the court found the agency's interpretation to have been *inconsistent* over the years and refuted the notion that an inconsistent agency interpretation of an ambiguous statute should be the sole parameter by which to assess trademark owners' rights.[113]

Act require foreign-manufactured, trademarked goods in question only be sold abroad. That is a contractual issue determined by the parties themselves.

109 *Id.* at 425.

> The principal purpose of statutory construction is to determine and give effect to Congressional intent. . . . To determine Congressional intent, the court must look to the language of the statute. . . . But statutory language cannot control if *clearly demonstrated* Congressional intent requires a different construction. . . . And in construing a statute, the administrative practice of the agency charged with administering the statute is entitled to substantial deference.

Id. (citations omitted) (emphasis added).

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> [Section 526] has been consistently interpreted by the United States Customs Service for the past 20 years as excluding from protection foreign-produced merchandise bearing a genuine trade-mark created, owned and registered by a citizen of the United States if the foreign producer has been *authorized* by the American trade-mark owner to produce and sell abroad goods bearing the recorded trade-mark.

Id. at 433 (quoting H.R. Rep. 138, 94th Cong., 2d Sess. 54 (1976)) (emphasis added). The House Ways and Means Committee had ample opportunity to amend the statute to provide greater coverage to trademark owners. Also, if Congress had been disturbed by Customs' monitoring of the gray market, it would have taken action to reprimand and require that Customs employ stronger measures to police the gray marketeers. Thus, "failure to alter § 1526(a) is sufficient indication of Congressional acquiescence in customs' administrative practice." *Id.*

111 *Vivitar*, 593 F. Supp. at 436.

> [The first contention was that] the legislative history of section 526 indicated that Congress intended the statute to protect only independent American purchasers of foreign trademarks, not related entities. Thus, because . . . [section] 133.21 merely denies protection to related entity trademark owners, the . . . regulation is consistent with the intent of section 526. [The second contention was that] the government urged that . . . section 133.21 reflects a longstanding interpretation of section 526 to which the court should duly defer. [Lastly], the government contended that Congress had implicitly ratified . . . [section] 133.21 by its failure to overrule the regulation in 1975 and 1978 when amendments to section 526 were debated.

Gray Market Controversy, *supra* note 69, at 81 (footnotes omitted).

112 *Vivitar*, 761 F.2d 1552, 1571 (Fed. Cir. 1985), *cert. denied*, 474 U.S. 1055 (1986).

113 *Id.* at 1568. In view of the administrative history, "Customs has had continuing questions concerning the reading of [section 526]. . . . Customs has attempted to adjust its regulations to reflect the few judicial decisions which interpreted the law prior to

In *Coalition to Preserve the Integrity of American Trademarks v. United States*,[114] The Coalition to Preserve the Integrity of American Trademarks ("COPIAT"), an association of American trademark holders, brought an action in federal court to invalidate section 133.21(c).[115] COPIAT contended that this regulation was inconsistent with section 526 and should be struck down.[116] It asserted that section 526 was plain on its face and to hold otherwise would deny any rights and protection offered trademark owners against infringement.[117] The United States countered that the language of section 526 was ambiguous. As such, an administrative agency must legitimately interpret the statute before the judiciary can intervene.[118] The United States maintained that section 133.21 was a legitimate and consistent interpretation of the trademark statute and, therefore, judicial intervention was unnecessary.[119]

The district court found that the agency policy had been consistent throughout its period of application.[120] Rearticulating

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1972." *Id.* Because of administrative law tenets, if the statute in question had a gap in its language, the court could not impose its interpretation on the pertinent administrative agency. This court, however, did not find such a gap to exist in section 526.

> Congress may . . . entrust an agency with the duty to exercise its judgment under guidelines set forth in a statute, and to fill in the extent of protection thereunder. . . . However, we find no language in the statute by which Congress delegated such *legislative* authority to the Secretary of Treasury in connection with administration of [section 526(a)]. Without such authority, Customs regulations cannot affect the actual scope of trademark owner's rights vis-a-vis an importer under the statute.

Id. at 1569 (citiation omitted)(emphasis in original).

Additionally, the court held the Customs' interpretation valid but not controlling. "Customs must . . . give effect to any judicial determination that the owner has a right to bar importation of goods bearing its mark, even though the goods were obtained from or through a foreign related company." *Id.* at 1556. The court concluded that gray market cases ought to be decided on a case-by-case basis because of the minimal legislative history behind the Tariff Act. *Id.* at 1570. This would result in gray market case law "developing . . . into protection against *sui generis* types of unfair competition in international trade." *Id.* The Supreme Court subsequently denied *certiorari*. 474 U.S. 1055 (1986).

114 598 F. Supp. 844 (D.D.C. 1984), *rev'd*, 790 F.2d 903 (D.C. Cir. 1986), *aff'd in part, rev'd in part, reh'ing granted sub nom.* K Mart Corp. v. Cartier, Inc., 485 U.S. 176, *reargued*, 486 U.S. 281 (1988).

115 Coalition to Preserve the Integrity of Am. Trademarks v. United States, 598 F. Supp. 844 (D.D.C. 1984) (*COPIAT I*).

116 *Id.* at 851. COPIAT's secondary argument stated that the subsection of the Customs regulation should at least be severed, if not entirely struck down, because it was inconsistent with the Tariff Act of 1930 and the Lanham Act. *Id.* at 846.

117 Plaintiffs added that because the statute was plain on its face, the court did not have to look to the legislative history to elicit congressional intent. *Id.* Defendant-intervenors argued that there was no evidence in the legislative history that pointed to the prohibition of parallel or "diverted goods." *Id.*

118 *See supra* notes 71-75 and accompanying text.

119 *COPIAT I*, 598 F. Supp. at 850.

120 Customs' attitude toward importation had always been that "[i]f the foreign producer has been authorized by the American owner to produce and sell goods abroad

the "reasonableness" standard established in *Vivitar*, the district court refrained from judicial extrapolation.[121] The District of Columbia Circuit reversed and remanded,[122] holding that the statute *was* plain on its face. Agency interpretation was therefore unnecessary.[123] Agency interpretation "only comes into play when it is apparent that 'Congress has not directly addressed the issue.' "[124]

The D.C. Circuit, in *COPIAT*, also found the regulation to be "an *unreasonable* administrative interpretation of section 526."[125] Viewing the legislative history with skepticism, the D.C. Circuit emphasized Customs' policy shifts regarding gray marketeering and found no room for implicit delegation of authority.[126] Ac-

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bearing the recorded trademark or trade name, merchandise so produced is deemed admissible by . . . Customs . . . ." *Id.*

[121] *Id.* at 852.

> [T]he task for a court is not to interpret a statute as it thinks best, but rather the narrower inquiry into whether the agency's construction is "sufficiently reasonable" to be accepted by the reviewing court; and . . . in order to satisfy this standard, it is not necessary for a court to find that the agency's construction is the only reasonable one or even the reading the court would have reached if the question had initially arisen in a judicial proceeding.

Id. at 851.

[122] Coalition to Preserve the Integrity of Am. Trademarks v. United States, 790 F.2d 903, 908 (D.C. Cir. 1986) (*COPIAT II*).

[123] "In this case, we believe that Congress' intent in Section 526 is clear, and thus 'that is the end of the matter.' " *Id.* at 908.

[124] *Id.* at 908 (quoting Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 843 (1987)).

> [C]ourts must exercise their independent judgment on the preliminary question of whether a statute unambiguously expresses congressional intent on the matter at issue; deference to an agency's interpretation becomes appropriate where the statute delegates authority to an agency to give content to flexible statutory terms or contains "gaps" that invite an agency role in interpretation.

Id. (quoting *Chevron*, 467 U.S. at 843-44). *See* Mesa Verde Const. Co. v. N. Cal. Dist. Council of Laborers, 861 F.2d 1124, 1129 (9th Cir. 1988) (court deemed that agency's interpretation of Act, "although perhaps not the only tenable one, [was] an acceptable reading of the statutory language and a reasonable implementation of the purposes of the relevant statutory sections."). *But see id.* at 1147 (The "proper function [of agencies] is to fill in policy gaps pursuant to an explicit or implicit delegation of authority from Congress . . . .") (Kozinski, dissenting).

In fact, section 526 does not address any consequences of the gray market, such as permission or impact. Because section 526 does not directly address impact or permission, such omission should constitute a "gap" referred to by the dissent in *Mesa Verde*. If a gap does exist in the legislation, then the burden of filling in the gap rests with the agency responsible for carrying out the legislation.

[125] K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 290 (1988) (emphasis added).

[126] "[W]e find that . . . Customs['] . . . interpretation of Section 526 does not display the necessary 'thoroughness, validity, and consistency' to merit judicial acceptance." *COPIAT II*, 790 F.2d at 916 (quoting Federal Election Comm'n v. Democratic Senatorial Campaign Comm., 454 U.S. 27, 37 (1981)).

> When Congress intends to effect so radical a departure from prevailing legal doctrine, it ordinarily acknowledges as much and does so in more than a single cryptic comment in a conference report. . . . Since Congress did not so much as hint that it was engaged in such an ambitious task, the more plausi-

cording to the court, the statute was clear enough and it "did not delegate authority . . . to . . . Customs . . . to adjust the scope of the statute . . . to its perceptions of changing economic circumstances."[127] The D.C. Circuit thus refused to accept the district court's rationalization that the ambiguity was sufficient to warrant agency interpretation.[128]

In *Vivitar*, *COPIAT*, and subsequent cases,[129] the trademark owner was not left remediless. Once the gray marketeer had imported the goods into the United States, the trademark owner

> ble reading . . . is that Congress intended merely to remedy a specific inequity that the prevailing doctrine produced, not to abolish the entire doctrine that produced it.

K Mart, 486 U.S. at 308-09. The District of Columbia Circuit dismissed the "legislative-acquiescence-equals-acceptance" argument espoused in *Vivitar* because it would unduly burden Congress with the responsibility of continually amending those federal agencies' interpretive actions which conflicted with legislative intent. *COPIAT II*, 790 F.2d 903, 917 (D.C. Cir. 1986), *aff'd* 485 U.S. 176 (1988). According to the Federal Circuit, that job belonged to the courts.

127 *COPIAT II*, 790 F.2d at 913. While the court delineated strong evidence to prove that Customs may have overstepped its bounds, it was forced to admit that some ambiguity remained. However, that ambiguity was curable through judicial, not agency, intervention. Paradoxically, the court required that "gaps" be present or authority statutorily granted to the agency before the court must defer, yet it admitted to the existence of those gaps in the statute itself.

128 "Section 526 does not, on its face, admit of any exceptions based upon the relationship of . . . American and foreign trademark owners or upon whether the American owner has authorized the use of the trademark abroad." *Id.* at 907-08.

129 Less than one year after *Vivitar*, the exclusive distributors for Olympus Corporation, a Japanese concern, brought a trademark infringement action against the United States. Olympus Corp. v. United States, 627 F. Supp. 911 (E.D.N.Y. 1985), *aff'd*, 792 F.2d 315 (2d Cir. 1986), *cert. denied*, 486 U.S. 1042 (1988). The Eastern District Court of New York upheld section 133.21 because under the agency interpretation, the American trademark holder and the foreign manufacturer were subject to the common control of the parent company of Olympus. *Olympus*, 627 F. Supp. at 921. While Customs was not obligated to take preventive measures, its inactions did not deprive the plaintiffs of private remedies. *Id.* at 919.

The Second Circuit affirmed the holding that the importation of gray market goods did *not* violate the Lanham Act and that section 133.21 was valid. *Olympus*, 792 F.2d at 321; Lipner, *Gray Market Goulash: The Problem of At-the-Border Restrictions on Importation of Genuine Trademarked Goods*, 20 CORNELL INT'L L.J. 103, 111 (1987) [hereinafter Lipner, *Gray Market Goulash*]. However, the court read sections 526 and 133.21 more expansively than the Federal Circuit had in *Vivitar*. It legitimized the "legislative-silence-equals-acquiescence" argument for section 526 dismissed by the *Vivitar* court and reasoned that any inconsistency existent in section 133.21 was excused by Customs' Herculean task to inspect every item of every shipment that enters the United States. "The administrative difficulties inherent in requiring . . . Customs . . . to exclude [would force] . . . Customs . . . [to] expend resources . . . when later private litigation could disclose that the markholder lacked isolable domestic goodwill and was merely engaging in price discrimination or other behavior . . . ." *Olympus*, 792 F.2d at 320.

The Second Circuit also suggested that the trademark holder seek private remedies. "The markholder still has rights under the statute: he may pursue private remedies against the importer under § 526(c), notwithstanding Customs' failure to exclude the goods." *Id. But see* Weil Ceramics & Glass, Inc. v. Dash, 878 F.2d 659, 673-75 (3d Cir. 1987) (private remedies are only available to trademark owners who seek to quiet title in their marks where similar mark has confused consumers), *cert. denied*, 110 S.Ct. 156 (1989).

could have brought an infringement action.[130] However, because Customs is not required to exclude all gray market goods *sua sponte*[131] and because trademark owners have private action remedies available to them, there was no need for the courts to strike down section 133.21.[132] The Federal Circuit, like the Second Circuit, found it unnecessary to invalidate Customs' interpretation because other remedies at law existed.

IV. *K Mart v. Cartier, Inc.*

The Supreme Court granted *certiorari*[133] to hear *COPIAT*[134] in an attempt to reconcile the split among the District of Columbia, Federal, and Second Circuits. The Supreme Court merged *COPIAT* with a contemporaneous gray market case, *K Mart Corp. v. Cartier, Inc.*[135]

In a splintered decision,[136] the Court severed the "authorized use" exception of section 133.21 without creating any concrete formulations for determining the legitimacy of the gray market.[137] Writing for the plurality, Justice Kennedy concluded

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130 Section 526(c) states that "[a]ny person dealing in any such merchandise may be enjoined from dealing therein *within the United States* . . . . " 19 U.S.C. § 1526(c) (1988) (emphasis added).

131 "[I]t is apparent that the regulations are not *contrary* to the statute in the sense that goods are being routinely excluded which should be admitted or *vice versa*." Vivitar Corp. v. United States, 761 F.2d 1552, 1569 (Fed. Cir. 1985).

132 Under section 526(c), trademark owners have the right to proceed against infringers once such infringement has been identified. The infringement victim can enjoin the infringer from further activity, but cannot institute an injunction prior to the infringement. *See supra* note 130.

133 K Mart Corp. v. Cartier, Inc., 479 U.S. 1005 (1986), *granting cert.*, Coalition to Preserve the Integrity of Am. Trademarks v. United States, 790 F.2d 903 (D.C. Cir. 1986).

134 598 F. Supp. 844 (D.D.C. 1984), *rev'd*, 790 F.2d 903 (D.C. Cir. 1986), *aff'd in part, rev'd in part, reh'g granted sub. nom.* K Mart Corp. v. Cartier, Inc., 485 U.S. 176, *reargued*, 486 U.S. 281 (1988). Gray market cases continued after the Supreme Court granted *certiorari*. *See, e.g.*, NEC Electronics v. CAL Circuit Abco, 810 F.2d 1506 (9th Cir.), *petition for reh'g denied*, 484 U.S. 851 (1987) (trademark law does not apply to parallel importation because trademark law primarily concerned with consumer confusion or deception).

135 486 U.S. 281 (1988).

136 The Court divided according to the separate subsections of the Customs regulation. Joining Justice Kennedy regarding Parts I and II-A were Chief Justice Rehnquist and Justices White, Blackmun, O'Connor, and Scalia. Justice Kennedy's opinion regarding Part II-B was joined by Justice White and his opinion regarding Part II-C was joined by Chief Justice Rehnquist and Justices Blackmun, O'Connor, and Scalia. Justice Brennan, who concurred in part and dissented in part, was joined by Justices Marshall, Stevens, and, regarding Part IV, Justice White. Justice Scalia, who concurred in part and dissented in part, was joined by Chief Justice Rehnquist and Justices O'Connor and Blackmun.

137 The Supreme Court first granted *certiorari* to *COPIAT* to determine the legitimacy of the claim of exclusive jurisdiction of the CIT over gray market trademark cases. 485 U.S. 176 (1988). The issue of exclusive jurisdiction is beyond the scope of this Note. For a thorough explanation, see generally Wolfe, *Attention K Mart Shoppers: In* K Mart v. Cartier, Inc., *the Supreme Court Granted District Courts Jurisdiction in Gray Market Disputes*, 10

that while the ambiguity inherent in the statute affected implementation of the first two subsections of section 133.21(c), it did not bear on the "authorized use" exception.[138] While domestic owners of foreign trademarks and domestic owners of domestic trademarks could seek protection under the regulation, foreign manufacturers producing foreign goods could not claim immunity under the United States trademark laws.[139] The plurality found that the "authorized-use" exception was inconsistent with section 526[140] and voided it while upholding the other two major exceptions of section 133.21.[141] The Court held that under traditional analysis, Customs' interpretation was a valid exercise of agency power.[142] A court only needs to find "arguable ambiguity" in the language of the statute to uphold the agency

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HASTINGS COMM/ENT L.J. 1131 (1988) [hereinafter *Attention K Mart Shoppers*]; *Gray Market Controversy*, *supra* note 69. Although the Supreme Court attempted to reconcile section 526 with section 133.21, it did not address the implicit argument regarding the legitimacy of Customs' allowance of gray market goods under section 133.21(c) in its decision. Instead, the Court focused on authorizing a standard for Customs' interpretation of section 526. *K Mart*, 486 U.S. at 285.

138 19 C.F.R. § 133.21(c)(3). Here, the majority gave (c)(3) "short shrift," *id.* at 296, and provided inadequate justification to substantiate its argument against upholding the subsection. This lack of perspicacity by the majority regarding the reality behind section 133.21(c)(3) is the essence of Justice Brennan's concurrence.

139 *Id.* at 283 ("the trademark must be 'owned by' a domestic firm to fall within [section] 526's ban"). *See* United States v. Guerlain, Inc., 155 F. Supp. 77 (S.D.N.Y. 1957), *vacated and remanded*, 358 U.S. 915 (1958), *dismissed*, 172 F. Supp. 107 (S.D.N.Y. 1959).

140 *K Mart*, 486 U.S. at 294-95. *See, e.g.*, Chevron, U.S.A., Inc. v. Nat'l Resources Defense Council, Inc., 467 U.S. 837 (1984), *reh'g denied*, 468 U.S. 1227 (1985) (court must determine whether Congress has spoken to specific statutory issue and if statutory language is ambiguous, whether agency interpretation is permissible). *See also* American Fed'n of Gov't Employees, AFL-CIO, Local 3090 v. Fed. Labor Relations Auth., 777 F.2d 751 (Fed. Cir. 1985) (FLRA decision to review subject to Administrative Procedure Act, 5 U.S.C. § 7123 (1988), and is entitled to considerable deference when applying review to matters within its reach, so long as reasonable); FAIC Sec., Inc. v. United States, 768 F.2d 352 (Fed. Cir. 1985) (question for court is whether agency interpretation is permissible).

141 *K Mart*, 486 U.S. at 294-95. Justice Scalia, while concurring with the general proposition that (c)(3) is an invalid construction of section 526, *id.* at 318, dissented from the majority validation of the first two sections of section 133.21(c). *Id.*

> This lawsuit would be different if the . . . regulation at issue . . . did no more than resolve [the] arguable ambiguity, by providing that a domestic subsidiary of a foreign parent could not claim the protection of § 526(a). . . . [T]hat has never been asserted to be the theory of the regulation. . . . The authority to clarify an ambiguity in a statute is not the authority to alter even its unambiguous applications, and § 526(a) unambiguously encompasses *most* of the situations that the regulation purports to exclude.

Id. (emphasis added). Justice Brennan, while participating in the majority opinion regarding the "common-control" exceptions of section 133.21, did not agree with the severance of the "authorized-use" exception. *Id.* at 312. "[Section] 526 does not unambiguously protect from gray-market competition a United States trademark owner who authorizes the use of its trademark abroad by an independent manufacturer . . . ." *Id.*

142 "[T]he common-control exception[s] of the Customs Service regulation § 133.21(c)(1)-(2) . . . [are] consistent with Section 526." *Id.* at 291. *See supra* notes 71-76.

interpretation.[143]

The Court found such arguable ambiguity in the language of section 526. It grappled, for example, with the intent behind statutory phrases such as "owned by"[144] and "of foreign manufacture."[145] It found this language to be sufficiently ambiguous to warrant agency deference because Congress had used precise phrasing to connote differing ideas in other statutes.[146] Consequently, the Court indirectly sanctioned the continuation of the agency's discretionary interpretation of the statutory requirements.[147]

Concurring in part and dissenting in part, Justice Brennan criticized the severance of the "authorized use" exception because it would afford all domestic trademark owners an untrammeled right to engage in monopolistic behavior.[148] He asserted that, if left unchecked, trademark owners could participate in price discrimination and vertical restraint.[149] A trademark owner with an unqualified right to exclude importation would "gain[] a virtual monopoly, free from intrabrand competition, on domestic distribution of any merchandise bearing on the trademark."[150] Justice Brennan also maintained that a domestic trademark

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143 *K Mart*, 486 U.S. at 293 n.4. This definition of arguable ambiguity allows for debate on the interpretation of a wide spectrum of statutes that have only a hint of equivocation in their language. "[W]hile reviewing courts should uphold reasonable and defensible agency constructions of their organic statutes, they should not 'rubber stamp . . . administrative decisions that they deem inconsistent with a statutory mandate or that frustrate the congressional policy underlying a statute.' " *American Fed'n of Gov't Employees*, 777 F.2d at 754 (quoting Bureau of Alcohol, Tobacco, and Firearms v. FLRA, 464 U.S. 89, 97 (1983)).

144 " '[O]wned by' is sufficiently ambiguous . . . in the context of the statute. . . . This ambiguity arises from the inability to discern . . . which of the two entities [in situations involving a foreign parent] . . . 'own[s]' the United States trademark if . . . the domestic subsidiary is wholly owned by its foreign parent." *K Mart*, 486 U.S. at 292.

145 *Id.*

146 "[A]gency regulations may give a varying interpretation of the same phrase when that phrase appears in different statutes and different . . . contexts." *Id.* at 293 n.4.

147 "All Members of the Court [agree] that the agency *may* interpret the statute to bar importation of gray-market goods" in instances where foreign firms incorporate a domestic subsidiary, granting that subsidiary the right to use the foreign trademark. *Id.* at 292 (emphasis added). This implies that the agency has discretionary power to interpret and enforce the statute.

148 Brennan examined the social and legislative history behind the statute and concluded that he could find no reason for Congress to grant to a domestic trademark holder the right to prohibit goods manufactured abroad under his authorization. *Id.* at 317. "The most blatant hint that Congress did not intend to extend [section] 526's protection to affiliates of foreign manufacturers . . . is the provision's protectionist, almost jingoist, flavor. Its structure bespeaks an intent, characteristic of the times, to protect only domestic interests." *Id.* at 297.

149 *Id.* at 295. *See infra* notes 221-30.

150 *K Mart*, 486 U.S. at 295. *See A Question of Free Trade*, *supra* note 9, at 330; Lipner, *Legality of Parallel Imports*, *supra* note 33, at 571-75; Note, *Trademark Law, Economics and Grey-Market Policy*, 62 IND. L.J. 753, 765 (1987) [hereinafter *Grey-Market Policy*].

owner who authorized a foreign manufacturer to use a domestic trademark was essentially perpetuating the trademark exhaustion doctrine.[151] Once a domestic owner licensed the use of his trademark abroad, he should not control subsequent sales of goods carrying his trademark.[152] Justice Brennan did not perceive the "authorized use exception" as unambiguous and declared that he would have upheld it on the grounds of reasonableness.[153]

Justice Scalia disagreed with Justice Brennan's reasoning concerning the "authorized use" exception and the plurality's upholding of the rest of the statute. In his dissent, Justice Scalia asserted that complications developed when the plurality sought to lend definitions to the regulation's language that the drafters may not have intended.[154] Justice Scalia claimed that there was no conflict between the definition of "foreign manufacture" in section 526 and Customs' interpretation in section 133.21.[155] Justice Kennedy had rendered the language indefensible by providing an unrealistic explanation of it.[156] Justice Scalia also con-

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151 > [I]f the United States trade-mark owner and the owner of the foreign rights to the same mark are one and the same person, articles produced and sold abroad by the foreign owner may be imported by anyone for the reason that the trade-mark owner has himself introduced the articles into commerce *or authorized such introduction* and may not unreasonably restrict the use of the product thereafter.

Letter from Commissioner of Customs, Joint Appendix at 53, *reprinted in* Supplemental Brief of Petitioners, *supra* note 16, at 5 (emphasis added).

152 *K Mart*, 486 U.S. at 295. *See infra* notes 203-13 and accompanying text. Perhaps courts should hold this domestic trademark owner who authorizes use to a stricter standard. The "authorized use" trademark owner should be well aware of the limitations on a possible monopoly in its contract with a foreign manufacturer.

153 *Id.* at 318. Although, as Justice Scalia pointed out, Justice Brennan utilized little contemporary case law to substantiate his argument, his judgment is pragmatic. Brennan contended that the "authorized-use" exception should be the first one validated because it actively involves the domestic trademark holder in direct creation of or negotiations with the foreign manufacturer. "Surely a domestic firm that establishes a manufacturing facility abroad . . . is not in any sense a foreigner, and it is at the very least reasonable to view as 'American' the foreign subsidiary of a domestic firm." *Id.* at 299.

154 "Words, like syllables, acquire meaning not in isolation but within their context. . . . The phrase 'of foreign manufacture' [for example,] is a common usage, well understood to mean 'manufactured abroad.'" *Id.* at 319.

155 *Id.* at 328-29.

156 Justice Scalia chided the majority for putting words in the mouth of Customs. *Id.* at 320. He maintained that any other interpretation of the regulation and statute would be antithetical to Customs' purposes for drafting the regulation in the first place. *Id.* at 322-23.

> I find it extraordinary for this Court, on the theory of deferring to an agency's judgment, to burden that agency with an interpretation that it not only has never suggested, but that is contrary to ordinary usage, to the purposes of the statute, and to the interpretation the agency appears to have applied consistently for half a century.

Id.

What Scalia chose not to recognize is that this argument, attempted by the Federal Circuit in Coalition to Preserve the Integrity of American Trademarks v. United States, tended that if the Court had read the plain meaning of the statute thoroughly, it would have been obvious that sections (c)(1) and (c)(2) were equally injurious to the domestic trademark owner.[157] "The U.S. assignee's innocent vulnerability to gray-market imports is no greater than that of the United States trademark owner who assigns the right to use his trademark abroad—and whom Justice Brennan would deprive of [section] 526(a)'s protection."[158] Therefore, Justice Scalia concluded that the entire regulation should be invalidated and that Customs should start over from scratch.[159]

By severing section 133.21(c)(3) from the Customs regulations, the Supreme Court in *K Mart* did not resolve the controversy surrounding section 526 and gray marketeering.[160] The

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790 F.2d at 916, fails to account for Customs' longstanding practice of allowing certain parallel imports to enter the country.

Justice Scalia refrained from attributing to the regulation an interpretation based on the Court's reading of legislative history. He also refused to pass judgment on congressional intent and prescience. *K Mart*, 486 U.S. at 328.

> Even if Congress could not have envisioned those other contexts I would find no reasonable basis to disregard what the statute plainly says; but to make the case complete, it surely must have envisioned them. . . . [W]e owe no deference to a construction that is contrary to the interpretation of the agency. I would therefore hold invalid, in addition to subsection (c)(3) of the regulation, subsections (c)(1) and (c)(2).

Id. at 328-29.

157 Subsections (c)(1) and (c)(2) pertain to same company or common control. *Id.* at 318.

158 *Id.* at 328. But it is interesting to note that Customs never assumed that position: "[T]he American registrant who authorizes foreign use of the mark controls the quality and marking of the goods and could differentiate quality, style or trademark *if it so chose*." Atwood, *supra* note 38, at 308 (emphasis added). Additionally, at least one author interpretes Kennedy's opinion to read that the American firm which purchases the rights to use a foreign trademark in the United States is injured when that foreign company subsequently licenses the same trademark to another American firm. This possibility does exist. If the first trademark holder wishes to protect itself, it has the option of entering an exclusive licensing agreement with the foreign company. *See Clouded Area*, *supra* note 56, at 954.

159 *K Mart*, 486 U.S. at 329.

160 The majority opinion suggests that Customs need not enforce against shell subsidiaries of foreign corporations. In the past, courts had stressed that foreign corporations should not be able to create shell organizations for the sole purpose of enlisting the aid of federal trademark law to protect their international concerns. *See supra* notes 99-102 and accompanying text. Instead, the administrative policies toward international trade in effect at the time of the action may govern whether or not Customs will be required to enforce the policies. This does not assure uniformity among courts.

As a result, this decision has only slightly curtailed Customs' practice of allowing importation of gray market goods. If there *is* an ambiguity in the statutory language, the Court cannot devise its own authorization gap-filler. To do otherwise would be judicial usurpation of legislative power. Courts must defer to the administrative interpretation unless the statute's language and legislative intent are clear-cut and the agency regulation directly contradicts the statutory intent. "[I]f a sponsor of legislation needs to understate the significance of a provision in order to secure its passage, it is reasonable to assume that other legislators relied on the sponsor's statements in casting their votes." *Id.* at 305 n.4 (Brennan, J., concurring). *See* Atwood, *supra* note 38, at 304. Otherwise, decision left the majority of domestic trademark owners in the same position they had occupied before *Vivitar*.[161] While the Court's reasoning was questionable, leaving the Customs regulation intact, for the most part, may have been the only rational solution to this problem. However, other authors have suggested alternatives such as economic efficiency and the copyright first sale doctrine, to either preserve the gray market or to remedy perceived wrongful conduct against trademark owners.[162] The arguments are plentiful, but solid answers for prohibiting or permitting gray markets are few.

V. Arguments for a Ban of the Gray Market

American companies operate foreign manufacturing divisions because when the American dollar is strong, it is generally more cost efficient to produce abroad. Labor and production costs are lower and overhead is minimal in comparison to rates in the United States.[163] These reduced production costs allow manufacturers to spend more on quality control and advertising.[164] As a result of this promotion and quality assurance, manufacturers establish a reputation in their relevant consumer markets as reliable producers of superior goods.

Once products enter the United States, manufacturers distribute the goods through authorized dealers. These dealers, either in conjunction with the manufacturers or of their own accord, determine the price at which the goods are to be sold.[165]

Congress must be the ultimate arbiter of the ambiguity. In this case, Congress had had ample opportunity to address the issue and declined to do so. "[W]ithout firmer evidence tending to impugn a legislator's integrity, the presumption that legislators mean what they say would seem more appropriate than the opposite presumption . . . . " *K Mart*, 486 U.S. at 305 n.4 (Brennan, J., concurring).

161 Fletcher & Kunstadt, Trademark Law Handbook 82 (Supp. 1989).

162 *See generally The Black and White of it All*, *supra* note 53 (copyright protection as a bar against gray marketeering); Note, *Preventing the Importation and Sale of Genuine Goods Bearing American-Owned Trademarks: Protecting an American Goodwill*, 35 Me. L. Rev. 315 (1983) [hereinafter *Protecting An American Goodwill*] (loss of goodwill outweighs benefits of gray market). *But see A Question of Free Trade*, *supra* note 9, at 323-26 (banning gray market goods results in windfalls to domestic trademark owners and limits free trade).

163 For a more extensive survey of the economic impact of foreign manufacturing divisions and international entities, see generally *A Question of Free Trade*, *supra* note 9; Liebeler, *Intrabrand "Cartels"*, *supra* note 37.

164 Olympus Corp. v. United States, 792 F.2d 315, 320-21 (2d Cir. 1986), *cert. denied*, 486 U.S. 1042 (1988).

165 A manufacturer usually maintains some control over the pricing of its goods, but is careful not to engage in resale price maintenance. "[A]n agreement between a seller and its buyer fixing the price at which the buyer may resell the product is a *per se* violation of section 1 of the Sherman Act." L. Sullivan, Antitrust 377 (1977) [hereinafter Sullivan]. To some extent, the seller must rely on market forces such as cost structure to determine the retail price of its product. Additionally, if an authorized dealer does not raise the price, it is probably because the product is new on the market and has not

Manufacturers and retailers ordinarily take several elements into account. They recognize costs such as competing dealers' prices for similar products, the degree to which their market is isolated, and overhead.[166] They must also calculate and incorporate lost sales resulting from gray market competition.

A. *Consumer Confusion*

"Likelihood of consumer confusion" is a primary concern of trademark owners when they participate in the marketplace.[167] Manufacturers strive to create readily recognizable trademarks to distinguish their products from other similar goods.[168] For example, a manufacturer insures that its product meets certain specifications and passes quality inspections before it is shipped for sale, guaranteeing customers the quality synonymous with the product. If a trademark owner succeeds at setting his product apart from the rest, the mark can become "distinctive," either immediately or through secondary meaning, and enjoys federal protection.[169] Once the product is successful, competitors are more likely to create a trademark similar but not identical to the successful mark to lure consumers away from the profitable original product.[170] Consumer confusion of source results when the purchaser cannot differentiate between the original trademarked good and the imitation.[171] As a consequence, the imitation prod-

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established itself as a reliable product or the goodwill has not affixed itself to that product. The dealer must combat the consumer's reluctance in purchasing an item which has no established goodwill, by lowering the price of its merchandise.

166 SULLIVAN, *supra* note 165, at 381. Prices of goods always include overhead, which presumes manufacturing and marketplace costs. Overhead costs usually incorporate the potential threat of the gray market, which is considered a cost of the marketplace. *See A Question of Free Trade*, *supra* note 9, at 323. For example, while phonorecords and cassette tapes (not blank ones) are relatively inexpensive to produce, their price on the marketplace will be increased to cover the cost of home recording and bootlegging. *See* Gruson, *Recording Companies File Suits*, N.Y. Times, Feb. 15, 1983, at D15, col. 3.

167 *See* 3 CALLMANN, *supra* note 41, § 20.07, at 28.

168 In statutory terms, a manufacturer seeks a mark that will instantly identify its "origin" or "source." *Protecting An American Goodwill*, *supra* note 162, at 315-17.

169 1 MCCARTHY, *supra* note 24, § 15:1, at 514. "Marks which are inherently distinctive are regarded as capable of functioning immediately upon use as a symbol of origin. . . . However, if a . . . symbol or word is *not* inherently distinctive, it can be registered . . . as a mark only upon proof that *it has become distinctive* [through] . . . 'secondary meaning.' " *Id.* (emphasis in original).

170 These competitors walk a fine line between originality and imitation. *See* 1 MCCARTHY, *supra* note 24, § 8:8, at 245 and § 24:3, at 58 (Supp. 1989). *See also* Boston Athletic Ass'n v. Sullivan, 867 F.2d 22 (1st Cir. 1989) (rebuttable presumption of consumer confusion where defendant intentionally created mark to lead consumers to believe merchandise was related to authorized event). This copying constitutes trademark infringement. *See supra* note 64.

171 In consumer confusion cases, defendants are held to a "reasonably prudent purchaser" standard. *See* 2 MCCARTHY, *supra* note 24, § 24:3, at 123.

The modern rule of law gives the trademark owner protection against use of uct detracts from sales of the original trademarked good because the similarity between the marks is too great for consumers to distinguish.[172]

Trademark owners oppose gray markets because of this potential for consumer confusion. They complain that gray markets mislead consumers, since consumers believe that they will receive the same quality product offered by the authorized dealer, when in fact, they purchase a potentially inferior genuine good.[173] Trademark owners suggest that the resale of genuine goods, while not a trademark infringement *per se*, generates "intrabrand" competition of which consumers are unaware.[174] Consumers allegedly purchase the good because of the trademark and reputation of the company. Consumers do not necessarily know, however, that the Nikon cameras that they buy were intended for foreign sale and as such, may not meet the specifications of authorized domestic dealers.[175]

Gray market opponents fail to recognize, however, that consumers today are more knowledgeable about products than they had been in the past. With the assistance of media, consumers educate themselves by accessing information concerning gray marketeers, authorized dealers, and the merchandise they sell.[176] Trademark owners would prefer blanket prohibition of entry of gray market merchandise, thus eliminating gray goods from the American market. In effect, trademark owners are making a choice for consumers. Prohibiting consumers' right to choice according to objective standards negates the idea of a free market and violates the spirit of the antitrust laws.

> his mark on any product or service which would *reasonably* be thought by the buying public to come from the same source, or thought to be affiliated with, connected with, or sponsored by, the trademark owner.

Id. (emphasis added). *See* Maier Brewing Co. v. Fleischmann Distilling Corp., 390 F.2d 117 (9th Cir.), *cert. denied*, 391 U.S. 966 (1968) (if trademark at issue is distinctive and actual or potential consumer confusion is likely to cause dilution, then trademark owner has cause of action under state dilution statute).

172 This theory presupposes that the imitation mark attaches to a product similar to the original trademarked good and has a lower sticker price than the original good.

173 One author maintains that gray market goods actually depreciate the worth of the product. If a consumer purchases a product at an authorized retail store, the worth of the product to the consumer will be greater than when that same product is purchased at a discount store. A consumer will be more willing to pay higher prices for the quality of services provided by the authorized dealer. Nolan-Haley, *supra* note 54, at 233.

174 *See supra* note 7 and accompanying text.

175 A trademark owner can combat this problem by manufacturing goods of like quality for both foreign and domestic sales.

176 A plethora of consumer rating magazines such as CONSUMER REPORT, as well as television, print, and radio consumer advocates aid buyers in making purchases.

B. *Misappropriation of Goodwill*

Misappropriation of trademark goodwill is inextricably entangled in consumer confusion and is a more potent argument against continuation of the gray market. Included in the retail price of a good is the goodwill of the trademark, which is the association a consumer makes with a product concerning its reliability, its performance, and its relative value.[177] For example, manufacturers offer exclusive warranties to support and promote their products.[178] Because gray marketeers sell unauthorized genuine goods, they cannot extend the same warranties. Therefore, those consumers who purchase genuine goods from a gray marketeer do not necessarily receive the same protection as those consumers who purchase from an authorized distributor. These sales, trademark owners allege, damage goodwill associated with the trademarks if the gray market goods do not withstand claims of quality made by trademark owners.[179]

As a result, trademark owners assert that gray marketeers "freeride" on the goodwill of the trademarked products and therefore misappropriate owners' rights.[180] This misappropriation, trademark owners contend, is the essence of unfair competition.[181] For example, gray marketeers do not offer the same quality control even though they sell genuine products.[182] Goods that would have been inspected and packaged by author-

[177] *See Protecting an American Goodwill*, *supra* note 162, at 332-33.

[178] *See, e.g.*, Osawa & Co. v. B & H Photo, 589 F. Supp. 1163, 1167-69 (S.D.N.Y. 1984); *Grey-Market Policy*, *supra* note 150, at 754-57.

[179] Original Appalachian Artworks, Inc. v. Granada Electronics, Inc., 816 F.2d 68 (2d Cir.), *cert. denied*, 484 U.S. 847 (1987) (material difference between goods manufactured abroad and those manufactured in the United States created consumer confusion).

[180] *Grey Market Policy*, *supra* note 150, at 755. *But see* American Honda Motor Co. v. Carolina Autosports Leasing & Sales, Inc., 645 F. Supp. 863, 865 (W.D.N.C. 1986) ("If the [d]efendants are 'free riding' it is because they sell a genuinely good product which has captured the American market from the American . . . manufacturers who have for too long been able to sell shoddy workmanship at an inflated price.").

Trademark owners also contend that gray marketeers freeride on advertising investments by either the distributor or manufacturer. *See, e.g.*, Nolan-Haley, *supra* note 54, at 234. Exclusive distributors or the manufacturers themselves allocate part of their budgets to mass media campaigns for their products. Larger corporations usually include this expenditure in their overhead. On the other hand, gray marketeers have every incentive to spend on advertising an amount relative to their size and inventory. If a large corporation loses any money on advertising, it undoubtedly recoups such loss on some other venture.

[181] Krumholtz, *supra* note 41, at 107.

[182] Service guarantees are most often tied to exclusive distribution agreements. *See* Nolan-Haley, *supra* note 54, at 236. *See also* Fantel, *Gray Market: Risks With The Bargains*, N.Y. Times, Nov. 20, 1988, (Arts & Leisure) at 25, col. 1. "For highly technical products, such as stereo equipment, . . . the service shop of the gray-market importer . . . most often lacks factory-trained technicians as well as authentic replacement parts and factory-prescribed test procedures." *Id.* at col. 3.

ized dealers do not undergo the same rigorous inspection and quality control procedures by gray marketeers.[183]

Parallel importation also denies authorized dealers the opportunity to insure the quality of their merchandise.[184] If the goods break, then unauthorized dealers may not honor the same warranties to repair the merchandise, nor is there a guarantee that any repair offered by gray marketeers will be as thorough as the authorized dealer's.[185] This refusal of service by unauthorized dealers erodes the goodwill of trademark owners and their authorized distributors.

Conversely, gray marketeers have everything to lose if they do not afford customers with knowledgeable sales representatives, reliable servicing and warranties. Just as with the authorized dealer, if the consumer is displeased with services provided by the gray marketeer, that consumer will not return to the gray marketeer to purchase goods in the future.

C. *Dilution of Trademark*

While trademark owners' claims of consumer confusion and freeriding on goodwill may not be strong enough to stand alone in court, combined they create a claim of dilution of trademark. State dilution statutes protect trademark owners against the "continuing use of a mark *similar* to the [trademark owner]'s [that] will inexorably have an adverse effect upon the value of the mark, and that, if he is powerless to prevent such use, [will eventually deprive the trademark owner]'s mark . . . of all distinctiveness."[186] Gray market opponents assert that gray markets dilute domestic trademarks. The trademark bestows economic benefits upon its owner in return for the time and expense the owner invests in warranties and service to create a quality product. The benefit is generated because the trademark identifies the source of the merchandise to consumers.[187]

If gray marketeers consistently undersell authorized dealers and offer little or no warranty on the merchandise, then consumers who purchase from gray marketeers will come to identify the

183 *See id.*

184 *See* Lipner, *Gray Market Goulash*, *supra* note 129, at 117-24; Nolan-Haley, *supra* note 54, at 236; *Grey Market Policy*, *supra* note 150, at 753-54.

185 *Id.*

186 3A CALLMANN, *supra* note 41, § 21.11, at 34 (emphasis added). *See* L.L. Bean, Inc. v. Drake Publishers, Inc., 811 F.2d 26, 31 (1st Cir.) (trademarks diluted "when consumer capacity to associate [them] with the appropriate products or services [is] diminished"), *cert. denied*, 483 U.S. 1013 (1987).

187 3A CALLMANN, *supra* note 41, § 21.06, at 21.

merchandise with the limited warranty and potentially inferior quality.[188] Consequently, consumers will not return to the authorized products because they presume the merchandise to be inferior. Moreover, if consumers are disappointed with the services provided, they will not return for the services and trademark owners' sales of their products will drop.[189] Trademark owners will no longer have any impetus to maintain production, quality control, or to continue advertising because consumers associate their trademarked merchandise with the "inferior" quality of the gray market merchandise. Eventually, trademark owners will abandon their mark because maintenance of gray markets have sacrificed the genuine product by diluting the worth of the trademarks.[190]

While trademark dilution is a formidable contention, it cannot apply to gray market goods. Dilution implies that the inferior merchandise in question bears a trademark "similar to" the infringed trademark. On the contrary, gray market goods bear trademarks identical to and authorized by trademark owners. While the potential for consumer confusion and freeriding on goodwill may exist, gray market opponents cannot automatically presume that parallel imports are inherently inferior products. Gray market merchandise bears marks that are nonetheless genuine, not imitative or counterfeit. They have been produced by the authorized foreign manufacturers with the blessings of trademark owners and do not mislead consumers about the source of the merchandise.

D. *Copyright as a Means of Protection*

An alternative argument for the prohibition of gray markets espoused by trademark owners is that parallel imports should be prohibited from using national copyright laws. Like trademark owners, copyright holders can determine and control the initial distribution of their products. Section 106 of the Copyright Act of 1976[191] awards copyright holders the exclusive right to distribute their copyrighted work.[192] Section 109(a) of the Act lim-

188 *See* Nolan-Haley, *supra* note 54, at 233-34.

189 *See id.*

190 "Because the public comes to associate trademarked goods with a certain standard of quality, a trademark guarantees that the goods on which it appears will meet public expectations about quality." *Protecting An American Goodwill*, *supra* note 162, at 315.

191 17 U.S.C. § 106 (1988).

192 "*Subject to sections 107 through 118*, the owner of copyright under this title has the exclusive right . . . to distribute copies . . . of the copyrighted work to the public by sale *or other transfer of ownership* . . . ." *Id.* at § 106 (emphasis added).

its section 106 by providing that "the owner of a particular copy . . . or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy . . . ."[193] This "first sale" doctrine restricts the monopoly granted to copyright owners by restricting their rights to distribution and redistribution.[194] Therefore, once a sale is completed, the first sale doctrine prohibits a copyright owner from extending his statutory monopoly over those goods because they are no longer within his control.[195]

The primary facet of the first sale doctrine is "control." A copyright holder no longer controls reproductions of his copyrighted work once those copies have been sold.[196] The copyright provides protection only up to that point of sale, withstanding any limitations established in section 602, which further limits section 109 by prohibiting the unauthorized importation of copies of the copyrighted work.[197] Thus, when viewed together, sec-

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193 *Id.* at § 109(a)(emphasis added).

194 H.R. REP. No. 1476, 94th Cong., 2d Sess. 79, *reprinted in* 1976 U.S. CODE CONG. & ADMIN. NEWS 5659, 5693-95.

195 *See First Sale Doctrine, supra* note 38, at 607-09. For example, the owner of a copyright in a sound recording cannot claim any rights in a particular copy of her recording when that recording has been sold to a purchaser. Tyson & Parker, *Parallel Importation of Copyrighted Phonorecords*, 10 N.C.J. INT'L L. & COM. REG. 397, 398-99 (1985) [hereinafter Tyson & Parker].

196 *See infra* note 197.

197 17 U.S.C. § 602(a) (1988). Section 602 states that "[i]mportation into the United States, without the authority of the owner of [the] copyright . . . of copies . . . of a work that have been acquired outside the United States is an infringement . . . under section 106. . . ." *Id.*

A further reading of section 602 of the Copyright Act appears to relieve Customs from barring importation of goods where a domestic trademark owner and a foreign manufacturer have entered into a licensing agreement. 17 U.S.C. § 602(b) (1988). Section 602(b) states in pertinent part: "In a case where the copies . . . were lawfully made, the United States Customs Service has no authority to prevent their importation unless the provisions of section 601 are applicable." *Id.* Section 601 states:

> (a) Prior to July 1, 1986, and except as provided by subsection (b), the importation into or public distribution in the United States of copies of a work . . . is prohibited. . . .
>
> (b) The provisions of subsection (a) do not apply—
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> . . . .
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> (7) where, on the date when importation is sought or public distribution in the United States is made—
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> . . . .
>
> (D) the copies were reproduced under a transfer or license granted by such author or by the transferee or licensee of the right of first publication . . . and the transferee or the licensee of the right of reproduction was not a national or domiciliary of the United States or a domestic corporation or enterprise.

Id. at § 601(a), (b)(7)(D). Like the affiliated subsidiaries or authorized parties in the trademark scenarios, a copyright holder cannot seek the protection of Customs where he has explicitly transferred certain distribution rights that inure to the copyright. Thus, it is possible to apply this doctrine to the domestic trademark holder who falls within one of the three categories set forth in section 133.21.

tions 106, 109, and 602 appear to prohibit parallel imports by limiting the distribution of copyrighted works to the copyright holder and those authorized by the copyright holder.[198]

The first sale doctrine presumes control by the copyright owner up to the point of sale. Like copyright holders, domestic trademark owners control their trademarks up until their initial point of sale.[199] They have negotiated their contracts for manufacture and distribution abroad and have had full interaction with those foreign affiliates or authorized parties regarding their trademarks. Hence, trademark owners have had the opportunity to determine where their trademarks will be distributed in the initial sale. It is contrary to the notion of the "first sale" doctrine to maintain that after a trademarked good is sold, a trademark owner reserves his right to control that good.

E. *Gray Markets Lead to Domestic Unemployment*

Opponents of parallel importation allege that gray markets not only lead to consumer confusion, misappropriation of goodwill, and dilution of trademarks, but also lead to a rise in domestic unemployment.[200] Gray marketeers increase competition within the relevant market and force authorized dealers out of business.[201] As a result, the continued maintenance of gray markets will cause high unemployment among employees of author-

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198 Some authors argue that these sections of the copyright law should be considered in formulating a viable substitute for section 526. *See generally* Donohue, *supra* note 38 (utilizing copyright laws to provide infringement relief); Tyson & Parker, *supra* note 195 (whether harmonizing copyright sections precludes any remedy to trademark infringement); *The Black and White of it All, supra* note 53 (clarifying ambiguities within copyright laws to provide relief for infringement victims). *But see generally First Sale Doctrine, supra* note 38 (copyright laws may not be employed to protect trademark owners). These proponents contend that the language of sections 106 and 602 should create in the copyright holder the right to control imports of the copyrighted work. "Under this interpretation, the first sale doctrine does not apply when goods are acquired outside the United States, and thus the importation prohibition is not restricted." *Id.* at 599. *But see* Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd., 664 F. Supp. 909 (D.N.J. 1987), *vacated*, 847 F.2d 1093 (3d Cir. 1988) (first sale doctrine extinguishes any distribution right the copyright owner holds to control or prohibit importation of copies); Kelly, *An Overview of the Influx of Grey Market Goods Into the United States*, 11 N.C.J. INT'L L. & COM. REG., 231, 233 (1986) ("[P]arallel imports, identical goods made in the same plant by the same maufacturer, should be allowed if the creator of the product has made its first sale and realized its profit incentive.").

199 *See infra* notes 203-13.

200 *See* Nolan-Haley, *supra* note 54, at 233. *See also A Question of Free Trade, supra* note 9, at 318; Letter to Donald T. Regan, dated Nov. 7, 1983, *reprinted in* Joint Appendix, Petition for Writ of Certiorari at 82, K Mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988); Osawa & Co. v. B & H Photo, 589 F. Supp. 1163 (S.D.N.Y. 1984).

201 *See* Barron, *Rise In Jobless Leads To Caution On L.I. Economy*, N.Y. Times, Aug. 22, 1982, (Long Island Weekly) at 1, col. 5-6 (Nikon Inc. dropped plans to open facility in Mitchell Field, New York because market earnings were lower due to gray market competition).

ized dealers.[202]

Gray market proponents counter that unauthorized dealers do not create unemployment, they remedy it. "Many small, unauthorized importers and retailers are likely to employ at least as many people as a few authorized importers."[203] In either event, unemployment of American workers is too minor a factor for courts and Congress to consider when weighing the benefits of gray markets.

VI. ARGUMENTS FOR MAINTENANCE OF THE GRAY MARKET

A. *Trademark Exhaustion and Territoriality*

The fundamental element of the trademark exhaustion doctrine is the idea that "once a trademarked good is placed into the stream of commerce . . . , the trademark owner can no longer sustain an infringement action" based upon that particular article.[204]

> [A] trademark owner has the right to prevent others from using his mark on *their* goods but does not have the right, merely by virtue of owning the mark, to limit the resale of his *own* goods once he has put them into commerce. . . . For example, Ford and General Motors can prevent an unrelated upstart automobile maker from attaching their trademarks to his cars, but they have no right under trademark law to prevent one of their own customers from reselling his [own automobile].[205]

Allowing a trademark owner to assert dominion over any subsequent disposition of his product once that product is sold constitutes an impairment of free trade and grants a monopoly to the trademark owner.[206] Because the owner receives his monetary benefit from the initial sale of the trademarked good, it makes little sense to afford him the economic benefit of succeeding sales.[207]

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202 *Osawa*, 589 F. Supp. at 1168. This argument is not only fallacious, but it is also jingoistic and protectionistic. The court in *Osawa* showed no evidence that gray marketeers do not employ as many, if not more, employees than authorized dealers.

203 *A Question of Free Trade*, *supra* note 9, at 318.

204 *Grey-Market Policy*, *supra* note 150, at 757.

205 Supplemental Brief for Petitioners, *supra* note 16, at 3 (citations omitted) (emphasis in original). *See* 3A CALLMANN, *supra* note 41, § 21.13, at 62 (Supp. 1987).

206 Gorelick & Little, *supra* note 35, at 227.

207 3A CALLMANN, *supra* note 41, § 21.17, at 74. Ordinarily, a foreign manufacturing subsidiary produces two groups of the same product. One group is slated for sales abroad, while the other is intended for sale in the United States. The trademark owner also prices the product differently, with the less expensive goods sold abroad. Those goods imported into the United States most often cost a good deal more at retail. Therefore, the Vivitar camera on sale in Bonn, West Germany, for example, will cost the consumer less than the Vivitar camera sold in St. Louis, Missouri.

"The purchaser [should be] . . . free to do whatever he will with the goods, to take them anywhere in the country, and to resell the *trademarked goods*, wherever he wishes."[208]

The resale issue differs only slightly with gray markets because they inevitably involve international considerations. When the domestic trademark owner establishes a foreign manufacturing subsidiary, the territory in which the subsidiary is based ought to be taken into consideration should any infringement action arise.[209] "The . . . idea of territoriality is appropriate for determining the jurisdiction of national trademark laws . . . ."[210]

United States law does not directly address this problem of application of laws. Under current United States law, trademark "territoriality" only applies if two or more unrelated parties in different countries own the same trademark.[211] "[T]erritoriality presumably makes the genuineness of the goods under the law of the foreign country irrelevant in mitigating its status as an infringement under the law of this country."[212]

In the domestic context, legitimizing a territoriality claim requires courts to weigh the validity of any potential vertical restraints against consumer interests protected under the Sherman Act.[213] If the trademark owner's control too closely resembles vertical restraint, a court will find an antitrust violation. Using territoriality to outlaw gray markets impedes subsequent sales because it reinforces a trademark owner's ability to define the secondary market geographically. Such control constitutes restraint and is antithetical to

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208 *Id.*

209 *Id.* at 74-75.

210 *A Question of Free Trade, supra* note 9, at 326-27.

211 19 C.F.R. § 133.21(b) (1989) states:

> (b) *Identical trademark.* Foreign-made articles bearing a trademark identical with 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.

Id.

212 3A CALLMANN, *supra* note 41, § 21.17, at 75.

213 Territorial restrictions will only be approved if they are "reasonable under the circumstances of the case, i.e. if the economic benefits to competition outweigh the disadvantages." *Id.* at 73. *See* Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977). It "does not necessarily mean that [territoriality protection] should be extended to a case involving goods of common origin representing only one goodwill." 3A CALLMANN, *supra* note 41, § 21.17, at 75-76. At least one gray market proponent argues that territoriality should not be a main consideration.

> Territoriality is irrelevant to the grey goods issue because the fact that a foreign corporation establishes a local subsidiary should not obscure the economic reality of *interdependence* between the local entity and the foreign entity. . . . [I]t is absurd to apply the principle so as to hinder international free trade and commerce, and such an extreme result raises questions about extraterritorial application of national laws.

A Question of Free Trade, supra note 9, at 326-27 (emphasis added).

notions of free trade.[214]

B. *Economic Efficiency and Free Trade*

Supporters of gray markets contend that prohibition of diverted goods would permit trademark owners to engage in monopolistic activities contrary to United States antitrust laws.[215] Under the Sherman Act, domestic distributors cannot practice, among other things, price discrimination or vertical restraints if such operations inhibit competitive activity.[216] Participation in resale price maintenance ("RPM") is a *per se* violation of the Sherman Act.[217] The Sherman Act prohibits RPM schemes because such agreements prevent distributors from adjusting their prices in accordance with what the market will bear.[218]

In one form of RPM agreement, a manufacturer sets a floor for the retail price of the good to be sold prior to delivery to a dealer.[219] Thus, the manufacturer restricts the distributor's right to compete freely in the market because the manufacturer determines, in essence, the retail price without accounting for interbrand competition and other circumstances exclusive to individual dealers. RPMs are not economically efficient because consumers cannot take advantage of competitive pricing and consequently will not purchase the goods.[220] Therefore, the public will not redistribute its wealth in the market, creating a "dead zone" in that industry.[221]

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214 *See generally* Derenberg, *Territorial Scope and Situs of Trademarks and Goodwill*, 47 VA. L. REV. 733, 750 (1961) (a rigid and inflexible appication of the territoriality rule may result in restrictive practices going beyond traditional trademark functions).

215 Supplemental Brief of Petitioners, *supra* note 16. "[Trademark owners] are essentially asking the Court to allow them to set the resale price of their products in the United States after they have sold those products, presumably at a profit, on the open market in other countries." *Id.* at 2.

216 15 U.S.C. § 1 (1988). Courts will uphold manufacturers' restrictions in select situtations by applying the rule of reason. "A restriction is illegal only if its anticompetitive effects outweigh its procompetitive effects." Liebeler, *Exclusion and Efficiency*, 3 AEI J. GOV'T & SOC'Y REGULATION 34, 35 (1987).

217 15 U.S.C. § 1 (1988). *See* SULLIVAN, *supra* note 165, at 377.

218 15 U.S.C. § 1. "Every contract, combination . . . or conspiracy, in restraint of trade or commerce among the several States . . . is . . . illegal." *Id.*

219 For a brief discussion of the implications of resale price maintenance, see generally SULLIVAN, *supra* note 165, at 379-87.

220 *Id.* at 377. If resale price-fixing did exist, but the manufacturer only held a small percentage of the relevant product market, then the net effect of the agreement on the consumer would be minimal. *Id.* at 379. Competing manufacturers producing similar goods could simply price that manufacturer out of his market. The danger lies where the price-fixing manufacturer controls the market totally. "[I]f the manufacturer is a monopolist, all resale price competition in the product market will be ended when it controls the resale price." *Id.*

221 " 'Price discrimination occurs when the same commodity is sold at more than one price, or when similar products are sold at prices that are in different ratios to marginal

More importantly, trademark owners who seek to control all points of foreign distribution participate in vertical restraint.[222] "Vertical restraints are restrictive distribution schemes that usually involve exclusive dealing by manufacturers or distributors. . . . [They] restrict output and raise prices for the ultimate consumer."[223] Manufacturers apply vertical restraints to insure, for example, methodical distribution of their merchandise by their exclusive retailers.[224]

Supporters of vertical restraint schemes employ a paradigm that, on the surface, justifies sustaining vertical restraints. In the paradigm, gray marketeers use the knowledge of authorized dealers to lure away potential consumers.

> [A] consumer gets the product information from the full service dealer, and then goes elsewhere and buys the product from a discount dealer. Hence, the discounter is free riding on the services of the authorized dealer, and vertical restraints are necessary to prevent unfair competition.[225]

While adherents of vertical restraint schemes assert that this paradigm promotes economic efficiency, it is not always so in practice.[226] If the goal of economic efficiency is to promote consumer wealth, then the consumer should ultimately decide from whom it purchases the goods.[227] Gray marketeers offer the merchandise at

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costs.'" Cohen, *supra* note 50, at 178 n.50 (1986) (quoting E. MANSFIELD, MICROECONOMICS: THEORY AND APPLICATION 308 (4th ed. 1982)).

222 "Vertical controls over distribution channels can enhance interbrand competition by facilitating distribution efficiencies and non-price forms of interbrand competition," *i.e.* dealer services and manufacturers' warranties. Nolan-Haley, *supra* note 54, at 236 n.20.

223 *A Question of Free Trade*, *supra* note 9, at 329.

224 *See* Steiner, *RPM, Distribution Restraints, and the Growth of Discounting: The Importance of Vertical Competition*, 15(2) ANTITRUST L. & ECON. REV. 73, 76-78 (1983) [hereinafter Steiner] (the author divides vertical restraints into distribution and price restraints).

225 *A Question of Free Trade*, *supra* note 9, at 331. *See* Steiner, *supra* note 224, at 77-78.

226 Proponents of vertical restraints often fail to take the reality of human nature into account, instead relying on supply and demand curves. It may appear undeniable that "any increase in the retailer's profit or the available customer services must necessarily increase output because otherwise the manufacturer would not allow the restraints." *A Question of Free Trade*, *supra* note 9, at 330. "Moreover, a flaw exists in the basic assumption that dealers and manufacturers are in a complementary relationship, because they are, in part, competitors." *Id.* at 331. For example, a manufacturer wants a retailer to sell more of its product, because such an increase in sales means increases in profits for the manufacturer. This increase in sales requires the retailer to lower its prices to attract consumers and lower prices mean lower profits for the retailer. *Id.* The bottom line is that consumers are, most often, less willing to spend more on an item if they can get that same item for a lower price. It does not necessarily matter to the consumer whether the authorized dealer offers an extended warranty.

227 *A Question of Free Trade*, *supra* note 9, at 333-37. *But see* Nolan-Haley, *supra* note 54, at 233.

lower prices and create incentives for consumer purchases.[228] Gray market importation is economically efficient because it maintains domestic price competition by offering consumers a greater selection of goods at considerably lower prices.[229] Manufacturers and authorized dealers artificially inflate the price of their merchandise to incorporate the costs of doing business. Gray marketeers often have fewer costs, so by charging less for merchandise, they can deflate the product price back to its "real" value.[230] If consumers' sole criterion for purchasing is retail price, then courts should not proscribe gray markets because they offer that which consumers seek—lower prices.[231]

VII. CONCLUSION

The gray market has evolved into a billion dollar industry,[232]

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228 *A Question of Free Trade, supra* note 9, at 336.

229 *See A Black Decision, supra* note 4, at 476 ("parallel imports benefit the United States economy because competition increases market efficiency"). *But see Grey-Market Policy, supra* note 150, at 777 ("A total ban on grey-market imports is the most efficient policy solution.").

230 "Foreign manufacturers and U.S. importers tend to keep retail prices artificially high in the United States, because they know United States consumers associate high price with quality." *A Question of Free Trade, supra* note 9, at 335. "Vertical controls over distribution channels can enhance interbrand competition by facilitating distribution efficiencies and non-price forms of interbrand competition." Nolan-Haley, *supra* note 54, at 236 n.20. *See* Continental T.V., Inc. v. GTE Sylvania, Inc., 433 U.S. 36 (1977). "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." Atwood, *supra* note 38, at 308. Justice Scalia in *K Mart* rationalized that the domestic mark holder "can either decline to participate in the assignment from the beginning, or contractually preclude the other party to the assignment from parallel importation." K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 328 (1988) (Scalia, J., dissenting). Not only is this argument weak, but it is contrapositive to Justice Scalia's contention. As Justice Scalia points out, "[i]t is not the affiliates who are doing the damage but third parties." *Id.* Therefore, if we are to take Justice Scalia's suggestion that "[t]he means of control available to the U.S. assignor are precisely those available to the United States assignee[,]" *id.*, and preclude the foreign assignee from parallel importation, then we are extending United States contract and trademark law into foreign affairs. It would be difficult, if not impossible, for an American to draft a contract which would induce a foreign manufacturer to deal solely with one American. This is patently unfair to the foreign manufacturer because it is protectionist and monopolistic.

231 It is ironic that those who espouse economic efficiency as a means to discredit the gray market must use the same argument that supports the gray market to defend their position. The authorized dealer and the gray marketeer are in the same business. They both participate in a consumer industry. Both have the same concerns, distributing quality products and promoting their goodwill. If the gray marketeer offers lower prices for the trademarked merchandise, then the consumer should decide whether to purchase the good at a lower price. If a trademark owner wants the consumer to purchase authorized merchandise, then he should not rely on claims of consumer confusion or goodwill infringement. Instead, he should compete more heartily with the gray marketeer by lowering his prices while maintaining his services. Otherwise, in the long run, the consumer will price him out of the market.

232 *See* Riley, *Gray Market Fight Isn't Black And White*, Nat'l L.J., Oct. 28, 1985, at 1, col.

signaling a demand by consumers for quality products at lower prices. Trademark owners and authorized distributors can no longer deal exclusively in products with the assurance that all they face is "interbrand" competition. The gray market heightened "intrabrand" competition, an additional market force with which trademark owners and distributors must contend. Third party distributors offer consumers that which consumers are primarily concerned—low-cost quality merchandise. While gray marketeers may not offer consumers comparable services and guarantees, they present consumers with an alternative to the higher prices that accompany such guarantees.[233]

Trademark owners seek to preserve their efforts in the marketplace because they have created products and reputations. Because parallel importation is legal, gray marketeers usurp the value of those products and reputations by infringing on the attendant trademark rights without fear of legal recourse. Both trademark owners and gray marketeers have a legitimate interest in promoting goodwill and enhancing reputation. Both parties stand to lose if consumers elect to patronize different establishments.

The Supreme Court in *K Mart Corp. v. Cartier, Inc.* did little to define the parameters of the role that the gray market should play in domestic trademark law. By invalidating the "authorized use" exception of the Customs regulation, the Court simply determined importation of goods bearing "authorized" trademarks without the permission of the domestic trademark owner to be distinguishable from importation of goods manufactured by a foreign company affiliated with the domestic trademark owner. In reality, unless the foreign manufacturer displays the source of the product and its potential affiliation with any domestic trademark owners in plain view, Customs agents face an almost insurmountable task of differentiating section 133.21(c)(1) or (2) goods from section 133.21(c)(3) goods.

Congress must ultimately decide the fate of gray markets either through a thorough redrafting of section 526 or an aggressive affirmation of section 133.21. Legislative silence on this matter is not enough. Courts have found that throughout its history, section 526 has been shrouded in ambiguity and they have endeavored to utilize all possible remedies to resolve this uncer-

3. "Stimulated by the rising value of the dollar abroad, the total value of the . . . market in gray goods may be as much as $10 billion annually." *Id.*

233 *See A Question of Free Trade, supra* note 9, at 332-33.

tainty. Should Congress be forced to decide this issue, it should weigh the arguments of trademark owners against those of consumer and free trade organizations. The bottom line should not be a question of administrative interpretation but of increased competition and consumer satisfaction.[234] "[T]he laws of supply and demand dictate that increased competition leads to lower prices, which in turn creates greater demand for a product."[235] No matter how egregious maintenance of the gray market may be regarding the rights of trademark owners, it is the most cost efficient method to insure that consumers ultimately determine price.

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234 "[T]he importance of trademark laws to the resolution of the grey goods controversy is outweighed by the overriding public policy considerations of international free trade." *A Question of Free Trade*, *supra* note 9, at 309-10.
235 *Id.* at 318 n.51.