THE GRAY MARKET: A CALL FOR GREATER PROTECTION OF CONSUMERS AND TRADEMARK OWNERS

LUCY J. MINEHAN*

1. INTRODUCTION

A gray market arises when a foreign manufacturer's goods, legitimately sold abroad, are imported into the United States to compete with those of the manufacturer who holds the United States trademark rights in the identical trademark.1 The gray marketeer is an "arbitrageur [who] takes advantage of a price difference between two markets by buying in the market where prices are lower and selling in the market where prices are higher."2 The market thrives on the unauthorized distributor's ability to sell the goods at prices considerably lower than those charged by the authorized distributor.3

United States trademark owners contend that gray market dealers pirate the goodwill established by the trademark owners in their businesses. With little financial spending, the gray market dealer capitalizes on "the benefits of the substantial investment of the United States dis-


1 A trademark is a word, design or picture used in connection with goods or services that represents the reputation or goodwill of the manufacturer or provider and signifies the quality of its goods or services. The mark therefore provides useful information for the consumer and aids in marketplace competition.


3 See Cleary and Landau, Gray Market Litigation: Battling the "Graying" of America, TRIAL, Mar. 1989, at 22 ("[t]he market for gray goods exists because both U.S. and foreign manufacturers often charge U.S. distributors as much as 40 percent more than foreign distributors for the same goods").

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Companies spend considerable time and effort promoting the goodwill of their products, a cost reflected in the products’ selling prices. The United States dealer has spent a great amount on advertising, quality inspections, and providing warranties and repair services. When the same products are purchased in a foreign market and imported into the United States, the gray marketeer is getting a free ride at the trademark owner’s expense, as the United States consumer has purchased the gray good expecting the “extras” provided by the authorized United States distributor. At least one court has held that free riding, which causes a drastic decline in sales and an increase in consumer confusion, is a sufficient basis for a preliminary injunction barring the importation and sales of the gray market goods.

Not only do gray market sales pirate the established goodwill, such sales endanger the trademark owner’s business reputation and goodwill by placing them in the hands of another business over which it has no control. Goodwill is damaged when, for example, the gray market version of a product lacks a warranty equivalent to that of the authorized dealer’s good. Other examples include non-English instructions, lack of repair servicing, incompatibility with United States electrical currents and non-compliance with United States health and safety codes. Goods that are not transported properly, particularly cameras, watches and electronic equipment, may not conform to the expectation of the buyer. Furthermore, the availability of items in discount stores arguably diminishes their prestige and results in consumer hostility directed toward the trademark. The availability of a lower-priced good is perceived by consumers as price-gouging on the part of the United States trademark owner. The lower price also contributes to consumers’ belief that the good is, in fact, a lower-quality good than what they thought they had purchased at the higher price. In all of these circum-

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5 See, e.g., Baldo, Score One for the Gray Market, Forbes, Feb. 25, 1985, at 74 (reporting that Duracell, a domestic trademark owner involved in recent gray market litigation, spent $150 million in promoting its United States market).
7 See id.
8 See Osawa, 589 F. Supp. at 1163.
10 See id.
stances, the trademark owner's goodwill has been reduced by the gray market good. To avoid consumer resentment and disturbing the goodwill, the trademark owner is often forced to perform free warranty service or to honor rebate offers for gray goods.

It is in response to this consumer hostility and diminished goodwill that the trademark owners seek recovery. Their claim is based upon the Lockean principle that an owner should not be deprived of the benefits of the goodwill obtained by the expenditure of energy, time and money.13

Proponents of parallel imports14 argue that the gray market has placed many formerly unaffordable goods within the reach of more consumers.15 However, the hidden costs and risks associated with gray market goods must be considered in an accurate assessment of the benefits to consumers.16

The gray market has expanded dramatically in the last ten years,17 a fact initially attributable to the United States dollar's rise in value relative to foreign currencies.18 The estimated size of the gray market19 and the variety of goods involved20 have given rise to heated

14 Gray market goods are also known as parallel imports because of their distribution route — from lower-priced foreign markets into the United States to be sold in direct competition with the goods of the authorized United States distributors. See Cleary & Landau, supra note 3, at 22. Gray market dealers prefer this term because it is less suggestive of any impropriety on their part.
15 For example, one retailer claims that its ability to deal in the gray market allows it to offer to its consumers Seiko watches for only $100 that would normally sell for $195 through authorized channels. Note, Gray Marketeers: Pirates of Goodwill or Vendors of Value?, 1987 COLUM. BUS. L. REV. 255, 257.
16 Gray market goods often lack the warranties, instructions, and servicing expected by the consumer. See supra notes 7-12 and accompanying text.
18 Nolan-Haley, supra note 4, at 232; Baldo, supra note 5, at 74. See, e.g., Why Camera Prices Are Falling, Bus. Wk., Sept. 6, 1982, at 61, 64 (comparing the gray market business in cameras to the commodity exchange as dealers watch foreign exchange rates and then traffic their cameras accordingly). But see Address by Mike Noll, Second Ann. Jud. Conf. of the U.S. Ct. of Int'l Trade (Oct. 23, 1985), reported in 31 PAT. TRADEMARK & COPYRIGHT J. (BNA) No. 755, at 36 (Nov. 14, 1985) (expressing the position of the International Trade Commission that economic considerations do not support gray market imports, rather the "price differences are justified by differences in services and investment [and] gray market goods get a 'free ride' on the reputation enjoyed by the mark as a result of efforts undertaken by its U.S. owner"). Propo- nents of gray market goods contend that the higher domestic prices are due to "deliberate price discrimination strategies pursued by trademark owners." Smart, Squaring the Gray Goods Circle, 10 CARDOZO L. REV. 1963, 1966 (1989).
19 See Riley, "Gray Market" Fight Isn't Black and White, NAT'L L.J., Oct. 28, 1985, at 1, col. 3 (estimating the size of the gray market at ten billion dollars annually). See also Boyer, supra note 17, at 89 (estimating the size of the gray market to be six
debates concerning the merits of a system which incorporates such goods.

This Comment contends that the current law, which almost always permits gray market importation, is in need of revision. Part 2 of this Comment provides an overview of the presently available means of resolving the situation. Additionally, Part 2 presents the limitations of the existing law which prevent it from properly balancing the rights of the United States trademark owners with those of the gray market importers and the United States consumers. Part 3 of this Comment proposes a solution that would more adequately protect the rights of the United States trademark owner without drastically reducing the benefits that the United States consumer receives from the importation of gray market goods.

2. SURVEY OF EXISTING METHODS OF COMBATTING THE GRAY MARKET

The United States trademark owner whose goods are forced into intra-brand competition may find remedies in several areas of law. Historically, trademark law has been employed, with varying degrees of success, as the primary method of attack on gray goods. The controversy over gray goods first arose in 1922 in A. Bourjois & Co. v. Katzel and A. Bourjois & Co. v. Aldridge. In both cases, the Supreme Court affirmed the trial courts' orders enjoining the importation of gray goods. However, trademark law can only effectively block gray goods upon a showing of confusion in the mind of the public with regard to the goods in commerce. In the event of genuine goods, a finding of

billion dollars per year); Crister, Trade War Erupts in Gray-Market Goods, Inc., Mar. 1986, at 19 (estimating that the total value of the market in these goods is eight billion dollars annually).


21 See infra text accompanying notes 23-115.

22 See infra text accompanying notes 116-132.


24 275 F. 539 (2d Cir. 1921), rev’d, 260 U.S. 689 (1923).

25 292 F. 1013 (2d Cir. 1922), aff’d per curiam, 263 U.S. 675 (1923).

26 See J. McCarthy, 1 TRADEMARKS AND UNFAIR COMPETITION § 2:6 (2d ed. 1984) (asserting that the “property in a trademark is the right to prevent confusion”).
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trademark infringement is not likely.\textsuperscript{27} Therefore, this Comment asserts that trademark law does not afford the United States trademark owner sufficient certainty of protection and relief from gray marketeers.\textsuperscript{28}

Trademark owners receive some protection through the exclusion of gray market goods at customs. Section 526 of the Tariff Act prohibits the importation of such goods.\textsuperscript{29} However, the Customs Service has, under the Tariff Act,\textsuperscript{30} promulgated regulations which prevent the exclusion of gray goods in a variety of circumstances.\textsuperscript{31} These regulations limit the effectiveness of Customs law as a weapon for United States trademark owners in their war against parallel importers.\textsuperscript{32}

The International Trade Commission recently investigated several gray market cases\textsuperscript{33} in which the trademark owners claimed unfair competition.\textsuperscript{34} The Commission however, operates under limitations\textsuperscript{35} preventing it from bringing certainty to this complicated area of the


\textsuperscript{28} See infra text accompanying notes 37-84.

\textsuperscript{29} The Tariff Act of 1930 is codified at 19 U.S.C. §§ 1301-1677 (1988). The Act provides, in relevant part:

\begin{quote}
[It shall be unlawful to import into the United States any merchandise of foreign manufacture if such merchandise, or the label, sign, print, package, wrapper, or receptacle, bears a trademark owned by a citizen of . . . the United States, . . . unless written consent of the owner of such trademark is produced at the time of making entry.
\end{quote}


\textsuperscript{30} 19 U.S.C. § 1624 (1988) authorizes the making of such rules and regulations as necessary to carry out the provisions of the Act.

\textsuperscript{31} According to the regulations, articles of foreign or domestic manufacture, bearing marks similar to United States trademarks, may not be denied entry when:

\begin{enumerate}
\item[(1)] both the foreign and the U.S. trademark or trade name are owned by the same person or business entity;
\item[(2)] the foreign and domestic trademark or trade name owners are parent and subsidiary companies or are otherwise subject to common ownership or control; or
\item[(3)] the articles of foreign manufacture bear a recorded trademark or trade name applied under authorization of the U.S. owner.
\end{enumerate}

19 C.F.R. § 133.21(c) (1990) (note that additional exceptions exist which have not been reproduced here).

\textsuperscript{32} See infra text accompanying notes 85-110.


\textsuperscript{34} 19 U.S.C. § 1337(a)(1)(A) (1988) declares unlawful any "[u]nfair methods of competition and unfair acts in the importation of articles" into the United States, the intent of which is "to destroy or substantially injure an industry in the United States."

The following more detailed analysis indicates the existing law's ineffectiveness in protecting the rights of United States trademark owners and consumers.

2.1. Protection Under Trademark Law

2.1.1. The Territoriality Theory of Trademarks

Prior to 1923, there were no limitations on the importation of foreign merchandise bearing trademarks identical to trademarks registered in the United States. In the seminal case of A. Bourjois & Co. v. Katzel, the Supreme Court held that, under certain circumstances, a third party's importation of trademarked goods from a foreign manufacturer could be enjoined. In Katzel, a French cosmetic manufacturer sold its United States face powder business, its goodwill and its United States trademarks to the plaintiff, a United States distributor. The defendant, finding the rate of exchange unfavorable, began purchasing the powder overseas from the French manufacturer and importing it into the United States, selling it in packaging similar to that of the United States trademark owner. The United States distributor showed that it had expended considerable effort in establishing goodwill for its business in the United States and claimed trademark infringement under section 27 of the Trademark Act of 1905. Justice Holmes, writing for the unanimous Court, recognized that the product "was sold and could only be sold with the good will of the business that the plaintiff bought." On that basis, the Court enjoined the defendant's imports.

The Court adopted what has come to be termed the "territorial-
"GRAY MARKET" theory of trademarks — the notion that "a trademark has a separate legal existence under each country's laws and its proper function is to symbolize the domestic goodwill of the domestic mark holder." The Court recognized that a trademark serves as more than an indication of the physical origin of a product; the trademark represents the independent goodwill of the trademark holder in a particular market.

Congress, too, has recognized the territoriality principle as evidenced by its 1962 amendment to section 32 of the Lanham Act. Prior to this amendment, plaintiffs in trademark infringement actions were required to show consumer confusion as to the source of origin of the products (i.e., confusion as to the manufacturer). Congress eliminated the "source of origin" language, clarifying its intent to include, as possible infringement, the use of trademarks which would be likely to cause confusion or mistakes of any kind, even as to the identity of the person or entity ensuring the quality of the goods in the United States. The territoriality principle has even been extended into the international realm.

2.1.2. Gray Market Goods Under the Lanham Trademark Act

a. In General

Today, most gray market cases pursuing a cause of action under the Lanham Act rely on sections 32 and 43(a). Section 32 protects...
the trademark owner against the use of a trademark that is a reproduction, counterfeit, copy or colorable imitation of a registered mark and that is likely to deceive or cause confusion or mistake. Section 43(a) protects the owner of a registered or unregistered trademark against false designation of origin, false description or misrepresentation that is likely to damage that trademark owner.

Trademark owners have been generally unsuccessful in combating gray market goods with either of the two provisions. By its terms, section 32 implicates only reproductions, counterfeits, copies or imitations of registered marks, not gray goods since they bear legitimate trademarks. The controversy surrounding gray goods does not concern their trademark status, rather, it focuses on the importer’s free riding on the authorized United States distributor’s goodwill. Consequently, section 43(a)’s false designation of origin provision enhances the trademark owners’ chance of recovery. Under that section, a gray market good can be banned when it materially differs from that of the United States trademark owner. Furthermore, it appears to protect the United States trademark owner against virtually identical products provided that the owner could show established goodwill separate from that of the gray good, even where the gray good is virtually identical.

However, the aforementioned regulations promulgated by the United States Customs Service further limit the protection given to the United

54 The text of section 32 is provided in part supra note 49.
55 Section 43(a) provides:

Any person who, on or in connection with any goods or services, ... uses in commerce any word, term, name, symbol, or device, ... or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person ... shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.

56 See supra note 49.
57 See supra text accompanying notes 4-13.
58 See supra note 55.
States trademark owner.  

b. Case Law Under the Lanham Trademark Act

To succeed in an action brought pursuant to either section 32 or 43(a), the plaintiff-trademark owner must demonstrate the existence of a likelihood of confusing the consumer. Inevitably, the courts' decisions are heavily fact-based, with some trademark owners succeeding and others being denied relief. In the cases dealing with goods that are not genuine, the courts have readily determined that there is a likelihood of confusion and have prohibited the importation of such goods. For example, in *Dial Corp. v. Manghnani Inv. Corp.* and *Dial Corp. v. Encina Corp.*, the respective courts found that modified Dial soap bars were likely to confuse the public in violation of section 32 and concluded that the sale of such bars constituted a false designation of origin in violation of section 43(a). Furthermore, the Connecticut District Court recognized that confusion could even be found where the imported goods were genuine.

In *Selchow & Righter Co. v. Goldex Corp.*, the court enjoined United States sales of Canadian-made Trivial Pursuit games. The court was influenced by the United States trademark owner's exclusive license to manufacture and sell the games in the United States and its modifications of the games to include its logo on the packaging, and, more importantly, a desire to eliminate certain questions from the Canadian version that were deemed unsuitable for family participation.

Although, as in *Manghnani*, the goods were not identical, the Southern Florida District Court in *Selchow* invoked the territoriality theory because it recognized that identical goods could confuse the consumer:

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61 For a more detailed discussion of the Customs regulations, see *supra* text accompanying notes 85-110.
65 The imported version of the soap differed from genuine, domestically manufactured Dial soap in antibacterial and deodorant effectiveness, size, and fragrance. See *Manghnani*, 659 F. Supp. at 1234.
66 *Manghnani*, 659 F. Supp. at 1238 (dictum). The court noted that even if a good were genuine, it could nevertheless deceive the public into believing that the domestic markholder's goodwill, as established through advertising, sales and servicing, stood behind the product. *Id.* (citing Weil Ceramics & Glass, Inc. v. Dash, 618 F. Supp. 700, 704-05 (D.N.J. 1985)).
68 *Id.* at 28-29.
69 See *supra* text accompanying notes 37-51 (discussing the territoriality theory of trademark).
[A] trademark represents the local or domestic goodwill of the owner of the national mark. Identical goods imported from another country are apt to confuse domestic buyers of the goods as to their origin. If the foreign goods are damaged, or are without a warranty, or are not of the same quality as the domestic goods, the goodwill and reputation of the domestic owner of the mark is injured.70

Courts are sometimes willing to find a likelihood of confusion based upon ancillary features of products when the genuineness of the goods is unclear. For example, in *Original Appalachian Artworks, Inc. v. Granada Elecs., Inc.*,71 the sale of Cabbage Patch Kids dolls accompanied by non-English language instructions and adoption papers was found to cause confusion among consumers. This was indicated by customer complaints, resulting in damage to the plaintiff's goodwill. The court was willing to apply the territoriality principle in finding infringement despite the fact that a single entity owned the trademark worldwide.72 The court realized that the significance of the United States trademark was the service it represented.73 For example, the processing of the adoption papers, enabling a doll's "parent" to receive a birth certificate and a first birthday card for the doll, could not be accomplished with the non-English language papers.

Unfortunately for trademark owners, not all courts are so receptive to the territoriality theory of trademarks. So while trademark owners are adequately protected by existing law in the event of modified or non-genuine goods, such is generally not the case when genuine goods are involved.74 In *NEC Elecs. v. CAL Circuit Abco*,75 the Ninth Circuit expressed its view that "[t]rademark law generally does not reach the sale of genuine goods bearing a true mark even though such sale is without the mark owner's consent."76 In that case the plaintiff, which had exclusive United States distributorship of the chips, was a wholly owned United States subsidiary of a Japanese manufacturer of semiconductor computer chips which were sold worldwide under the NEC trademark.77 The plaintiff brought an action under sections 3278 and

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70 Selchow, 612 F. Supp. at 28.
71 810 F.2d 68 (2d Cir. 1987).
72 See id. at 73.
73 See id.
74 Steiner & Sabath, supra note 27, at 440.
75 810 F.2d 1506 (9th Cir. 1987), cert. denied, 107 S.Ct. 436 (1987).
76 *NEC Elecs.*, 810 F.2d at 1509.
77 See id. at 1507.
43(a)\(^7\) of the Lanham Act against a third party that had purchased the parent company’s chips abroad and sold them in the United States in direct competition with the plaintiff’s chips and under the same mark. The Ninth Circuit refused to enjoin the sale of the gray market chips despite evidence indicating that United States purchasers of the imported chips mistakenly thought their chips were protected by the servicing and warranties of the authorized United States distributor.\(^8\)

When such consumer confusion exists the United States trademark owner’s goodwill is put at risk. Consumers grow hostile toward the trademark when denied the warranty and servicing expected. This hostility is then directed toward the good and, indirectly, toward the United States trademark owner. Although the decision is only binding on the Ninth Circuit, its implications are far-reaching, especially since that circuit contains many critical points of entry into the United States for gray market goods, including Los Angeles, San Francisco, Seattle and Honolulu.

The courts’ ability to dismiss customer confusion, as in \textit{CAL Abco}, clarifies the need for legislation protecting the interests of both trademark owners and consumers. Trademark owners spend a great deal of time and money promoting the goodwill of their products. Allowing gray marketeers such easy entrance into the United States, as the Ninth Circuit did, diminishes the ability of United States trademark owners to maintain their goodwill with the public. This gives rise to greater customer dissatisfaction, and, in the long run, hurts the consumer who is left to receive products of lower-than-expected quality, lacking in warranties and servicing. Even in the event of identical goods, it is imperative that consumers receive the “extras” they have come to expect.\(^9\)

Although some courts invoke the territoriality theory,\(^10\) they are outnumbered by those that altogether reject the notion that genuine goods can cause public confusion.\(^11\) In foreclosing the possibility of a

\(^7\) 15 U.S.C. \$ 1125(a) (1988).
\(^8\) See NEC Elecs., 810 F.2d at 1508.
\(^9\) Such “extras” include warranties, servicing, instructions, rebates, and compliance with United States safety, health and electrical standards. See notes 7-12 and accompanying text.
trademark action against genuine goods, courts fail to recognize the ability of a domestic markholder to develop a separate and independent goodwill for the product. 84

This Comment asserts that the courts have rendered the current trademark law ineffective in combating the infringement of the United States trademark owners' rights. The courts have succeeded in removing all certainty and predictability of relief for domestic markholders in the event of infringement by gray market goods.

2.2. Protection By Exclusion at Customs

Theoretically, gray marketeers can be enjoined from importing their goods by the United States Customs Service. 85 From its inception, this area of customs law has been intertwined with the case law under the Trademark Act of 1905 86 and later, with the case law under the Lanham Trademark Act of 1946. 87 Section 526 of the Tariff Act of 1930 88 was added as a result of the intermediary court's decision in A. Bourjois & Co. v. Katzel. 89 In that appellate decision, the Second Circuit reversed the district court's order enjoining the importation of face powder. 90 The court reasoned as follows:

Trade-marks . . . are intended to show without any time limit the origin of the goods they mark, so that the owner and the public may be protected against the sale of one man's goods as the goods of another man. If the goods sold are the genuine goods covered by the trade-mark, the rights of the owner of the trade-mark are not infringed. 91

The legislative history of section 526 reveals Congress's concern

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84 But see Comment, Gray Market Imports: A Genuine Problem for the United States Trademark Owner, Customs Service, and Courts, 7 NW. J. INT'L L. & BUS. 762, 781 (1986) (arguing that the cases denying protection against genuine goods should not be considered persuasive for the proposition that genuine goods cannot cause confusion).
89 275 F. 539 (2d Cir. 1921), rev'd 260 U.S. 689 (1923).
90 274 F. 856 (S.D.N.Y. 1920).
91 See supra text accompanying notes 39-41 (providing a more detailed discussion of the facts of the case).
92 275 F. at 543.
with the intermediary Katzel decision.\textsuperscript{98}

A recent decision of the circuit court of appeals holds that existing law does not prevent the importation of merchandise bearing the same trade-mark as merchandise of the United States, if the imported merchandise is genuine and if there is no fraud on the public. The Senate amendment makes such importation unlawful without the consent of the owner of the American trade-mark, in order to protect the American manufacturer or producer . . . .\textsuperscript{94}

Although clearly concerned with the Second Circuit's decision, Congress did not elaborate on the scope of proposed Section 526. Customs subsequently promulgated regulations that created exceptions\textsuperscript{95} to the law of section 526.\textsuperscript{96}

The regulations employ a relationship-based rationale clearly enunciated in United States v. Guerlain, Inc.\textsuperscript{97} In that case, the court, motivated in part by concern with monopoly and antitrust principles, denied protection to a United States company on the grounds that it was part of a single international business enterprise with a foreign company. The most common exception to the section 526 ban on importation occurs when a relationship exists between the foreign trademark owner and the United States trademark owner.\textsuperscript{98} Such a regulation is troublesome for its assumption that any party holding the rights

\textsuperscript{98} Note that in the Supreme Court's eventual reversal of the Second Circuit, no reference was made to the recently passed legislation. However, the Court reached a decision in accordance with section 526, by viewing trademarks as not only indicators of the original, physical source of the product but also as indicators of those through whose hands the goods have passed. 260 U.S. at 692.

\textsuperscript{94} H.R. REP. No. 1223, 67th Cong., 2d Sess. 158 (1922).

\textsuperscript{95} Such regulations were first promulgated in 1936, and the exceptions were broadened in 1953 and 1959. In 1972, Customs adopted the current version. The exceptions originated in United States v. Guerlain, Inc., 155 F. Supp. 77 (S.D.N.Y. 1957). Guerlain was a wholly owned United States subsidiary which sold perfumes purchased from its French parent company at a higher price than that at which they were sold at overseas. The United States Government charged the exclusive United States distributor with violating section 2 of the Sherman Antitrust Act, 15 U.S.C. § 2 (1988), which provides that "[e]very person who shall monopolize . . . any part of the trade or commerce with foreign nations shall be guilty of a felony." The distributor then sought protection under section 526 of the Tariff Act. The district court held that section 526 could not be invoked by a United States company that was part of a single international business enterprise with a foreign company. 155 F. Supp. at 91. The court determined that Guerlain's invocation of section 526 was for the purpose of excluding competition and controlling price levels and was, therefore, a monopolization. \textit{Id.} at 90-91.

\textsuperscript{96} See \textit{supra} note 31 (enumerating the most commonly employed exceptions).

\textsuperscript{97} 155 F. Supp. 77 (S.D.N.Y. 1957).

\textsuperscript{98} See \textit{supra} note 31.
to a United States trademark and affiliated with a foreign concern is trying to take advantage of the United States consumer.

In response to the regulations, trademark owners began seeking declaratory judgments that the Customs regulations had invalidly interpreted section 526. In *Olympus Corp. v. United States*, and *Vivitar Corp. v. United States*, the Courts of Appeals for the Second Circuit and the Federal Circuit, respectively, upheld the validity of the Customs regulations. However, it would be inaccurate to characterize either decision as a whole-hearted endorsement of the regulations. One commentator has analyzed the decisions as upholding the validity of the regulations, but only "with the caveat that these regulations do not limit a United States trademark owner's right to pursue a private cause of action." In other words, even though the regulations may be questionable, they were upheld because of the availability of other means by which recourse could be had — namely, the trademark law. However, in examining the trademark owners’ private remedies under the Lanham Act, this Comment concludes that such remedies are ineffective. Furthermore, in reaching its decision, the Second Circuit adopted the argument that Congress's refusal to act (i.e., to strike down the regulations) indicates its approval of the regulations as consistent with the Act. However, an equally strong (or weak) argument can be made that Congress' failure to incorporate the regulations into the statute indicates its rejection of the regulations. The argument is equivocal at best.

The Supreme Court recently addressed the validity of the Customs regulations in *K Mart Corp. v. Cartier, Inc.* In this complicated consolidation of three cases, a plurality of the Court drew the line between lawful and unlawful gray market imports, finding the regulations valid insofar as they permitted the importation of gray goods where the United States trademark owner had authorized an unaffiliated company to use the mark overseas. In other words, the regulations

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100 792 F.2d 315 (2d Cir. 1986).

101 761 F.2d 1552 (2d Cir. 1985).


103 See text accompanying notes 53-84.


were upheld, except for the authorized use exception. Economically, the Supreme Court's decision will have little effect on the gray market as only a negligible portion of all gray market imports can be categorized into this exception.\textsuperscript{106}

Under the Court's ruling, as long as a relationship can be shown to exist between the United States trademark owner and the foreign trademark owner, goods cannot be banned. The decision even denies the protection of the Tariff Act where the gray marketeer is a third party unrelated to the United States trademark owner or its foreign affiliate. Much debate has arisen over the logic of such line drawing. There are many instances in which a United States subsidiary of a foreign manufacturer is a substantial enterprise in its own right.\textsuperscript{107} The regulation unfairly presumes monopolistic practices and price discrimination tactics on their part. Often, the higher price in the United States market is justifiably attributed to added features of the products intended for the United States market.\textsuperscript{108} Allowing the distributors of the gray goods a free ride on the goodwill of the United States trademark owner strips the trademark owner of the rights in the mark. The Court's decision is therefore unsatisfactory for its lack of logically based line drawing\textsuperscript{109} and failure to address the issue of the private course of action available to trademark owners.\textsuperscript{110} Trademark owners are effectively left with the diluted protection offered by section 526 of the Tariff Act and the inconsistent protection of the courts under the Lanham Trademark Act.

2.3. Protection Given by the International Trade Commission

Recently, the International Trade Commission\textsuperscript{111} has addressed the issue of gray market goods. Trademark owners have had some positive results.\textsuperscript{112} However, in \textit{In re Certain Alkaline Batteries},\textsuperscript{113} the In-
ternational Trade Commission found that a United States trademark had been infringed by gray goods that, because of transportation conditions, were inferior to the similarly trademarked batteries for sale in the United States. On its facts, the case seemed ideal for banning, the remedy eventually ordered by the Commission. Not only were the rights and goodwill of the United States trademark owner threatened, but so were the rights of the United States consumers to receive a product of expected quality. However, President Reagan overturned the Commission's resolution of this issue for what he ambiguously termed "policy reasons." These reasons were never disclosed, thus further manifesting the uncertainty and unpredictability plaguing this potential means of recourse for United States trademark owners and consumers.

3. RECOMMENDED SOLUTION

As demonstrated, United States trademark owners who have built up independent goodwill in this market are inadequately shielded from unauthorized parties seeking to profit at the markholders' expense. While one may sympathize with the trademark owners, they are entitled to no recourse except in those situations in which the goodwill they have established is threatened. After all, it is in the best interest of consumers to allow them to obtain the same products at lower prices by shopping elsewhere.

Several members of Congress have recently introduced bills intended to clarify this gray area of the law. In 1988, Senator Hatch introduced Senate Bill S. 2903, otherwise known as the "Trademark Protection Act of 1988." Senator Hatch summarized the proposed amendment to the Lanham Act as follows:

Under its provisions the Lanham Trademark Act is amended to provide that no person may import into or sell within the United States any good that is manufactured outside the United States if that good bears a trademark that is identical to a trademark owned and properly registered by a person, corporation, or other entity, unless the U.S. trademark owner consents to such sale or importation.

This prohibition would apply regardless of whether the foreign manufacturer of the goods or foreign trademark

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114 Id.

https://scholarship.law.upenn.edu/jil/vol12/iss3/5
owner whose trademark appears on the goods is related in any way to the owner of the U.S. trademark. The prohibition would also apply regardless of whether the owner of the U.S. trademark owns or has registered the trademark abroad. And, finally, the prohibition would apply regardless of whether the owner of U.S. trademark has authorized the use of the trademark abroad.\(^{117}\)

That same year, Representative Chandler introduced a bill into the House of Representatives\(^{118}\) that, if enacted, would have incorporated the existing Customs regulations\(^{119}\) into section 526 of the Tariff Act of 1930.\(^{120}\) The bill was the counterpart to an earlier bill Senator Chaffee had introduced in the Senate in 1987.\(^{121}\)

Neither side of this debate has been able to advance its view successfully. This Comment contends that to be successful in resolving the gray market situation, legislation must effect some sort of compromise rather than emphasizing either extreme view.

Before legislation can be drafted, the interests of all parties must be evaluated. Then, appropriate means for protecting the interests must be determined. United States consumers have a strong interest in paying the lowest price available for a genuine good. The consumers, however, have certain expectations with respect to warranties, servicing, rebates, and compliance with United States health and safety standards which must be met.\(^{122}\) In turn, United States trademark owners rightfully expect that the goodwill of their products will not be undercut by goods bearing the same trademark, but of lesser quality or lacking in features such as warranties and servicing. However, the trademark owners' rights cannot extend so far as to ban those imported goods which are genuine in all respects and in which consumer expectations are satisfied. Giving such an unlimited right to trademark owners would provide them with monopolistic powers.\(^{123}\) Furthermore, the


\[^{119}\] 19 C.F.R. § 133.21(c) (1989) (reproduced supra note 31).


\[^{122}\] See supra text accompanying notes 7-12.

\[^{123}\] One commentator has written that:

[i]f trademark law were found to prohibit gray market imports in their entirety, . . . a firm with foreign affiliates could use it to implement price discrimination against domestic markets. By prohibiting gray marketeers attracted by price disparities from arbitraging genuine "foreign" goods between international markets, the trademark owner could create a wall
presumptions underlying the existing regulations issued by the Customs Service are unfair to trademark owners and should not form the premise of any proposed legislation. The regulations presume price discrimination against United States consumers in the event of related domestic and foreign companies.

This Comment urges the adoption of the California Gray Market Goods Act (the Act) as a starting point in developing legislation. The Act requires all those involved in the retail selling of gray market goods to make certain affirmative disclosures about gray market merchandise. The Act further mandates posting a conspicuous sign at the product's point of display and affixing to the product a conspicuous label disclosing certain information when appropriate, including the inapplicability of the manufacturer's warranty, incompatibility with United States electrical currents or broadcast frequencies, unavailability of replacement parts or compatible accessories, absence of English instructions, ineligibility for manufacturer's rebate, and any other non-conformity with relevant domestic standards known to the seller.

The Act, as evidenced by its provisions, was clearly designed to protect consumer interests. However, it contains several ambiguities that prevent it from providing complete protection. First, by its terms, the Act only applies to "retail sellers"; an importer or wholesaler probably would not be subject to the penalization (i.e., liability to the buyer and possible charges of unfair competition).

Furthermore, the definition of "gray market goods" unnecessarily limits them to consumer goods, imported into the United States via un-
authorized channels, bearing a trademark and, though normally accompanied by an express written warranty, not accompanied by any such warranty.\textsuperscript{130} Gray marketeers can use this limiting definition to exclude their goods from the category. Since the modification of goods often voids the entire manufacturer's warranty, modified goods will no longer fit the definition of gray market goods and the retailer will not be bound. Clearly, these ambiguities need to be resolved to fully protect the consumer.

The California statute also raises serious constitutional difficulties by imposing a state statute on a foreign or out-of-state entity.\textsuperscript{131} Therefore, this Comment recommends adopting, at the federal level, legislation similar to that of California but without its ambiguities. The proposed legislation should apply to a more inclusive group — all those involved in parallel importation. Furthermore, the term "gray market goods" must be defined in a way that precludes gray marketeers from manipulating it. This Comment proposes eliminating the warranty requirement contained in the California definition. Instead, the following definition is recommended: consumer goods which are imported into the United States through channels other than the manufacturer's authorized United States distributor and which bear a trademark. Such a definition is broad enough to be free from manipulation.

The California statute, although clearly cognizant of consumer interests, does not directly address the concerns of trademark owners. Adopting the labeling policy will diminish the consumer confusion that results in free riding.\textsuperscript{132} To say, however, that the confusion would be altogether eliminated would be misleading. Even with strict labeling requirements, there exists the strong possibility that the consumer will be dissatisfied with the gray good and will direct such hostility at the trademark in general. There must be a remedy for the trademark owner in such an instance; or better yet, such an instance must be prevented.

Section 526 of the Tariff Act would seem to provide the best protection for owners. The Supreme Court, however, upheld the exceptions to that section's ban on importation based on ambiguities in its provisions. This Comment urges Congress to reexamine section 526 and the regulations promulgated thereunder and clarify the underlying intent. In its examination, Congress should recognize the inherent ineq-

\textsuperscript{130} See id. at § 1797.8(a).


\textsuperscript{132} Consumer Interests, supra note 45, at 863.
uity of the presumption underlying the Customs regulations. Upon such recognition, Congress can adopt a more rational rule, looking to factors other than the existence of a relationship between the domestic and foreign enterprises. The nature of the relationship in a particular case requires detailed examination. Admittedly, this burdens Customs and the judiciary. However, this Comment posits that the slightly increased burden must be accommodated in order to protect fully the rights of United States trademark owners.

4. CONCLUSION

The size of the gray market and the variety of goods passing through it make it an important and lasting issue. It is, therefore, imperative to find a solution that will accommodate the interests of United States trademark owners in protecting their good will and the interests of consumers in paying the lowest price possible for a good and in receiving expected product quality. This Comment recommends strict labeling which would adequately protect the consumer willing to take the time to become aware of product differences. However, many consumers, despite labeling, will make uniform purchases and become hostile to the trademark. As extra protection for the markholders, the recommended legislation eliminates the bright-line rule currently in place, under which the finding of a relationship between the foreign and domestic businesses precludes a ban on the imported good. In its place, the proposal suggests a deeper inquiry into the nature of the relationship to determine whether the United States mark owner should be estopped from banning importation of the good. The recommended solution will effectively protect the trademark owners' rights in their marks without impinging on the ability of consumers to purchase the goods of their choice.