GRAY MARKET GOODS: WHAT PROTECTION AFFORDED?

AN AMERICAN PERSPECTIVE WITH A EUROPEAN COMPARISON

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I. INTRODUCTION

Generally, gray market goods pose a problem for American manufacturers because foreign made goods usually begin as validly trademarked goods under United States law and subsequently end up in the United States to compete directly with the identical goods that are authorized for sale in the United States.[1] On one hand, the argument goes, these goods are legitimate, trademarked goods and should be allowed into the United States. The imports enhance competition and contribute to lower prices. On the other hand though, the flow of these goods constitutes unfair trade practice and should be prohibited.[2] Business groups have recently argued before the Senate that gray market goods give the importer a free ride on the trademark owner's goodwill and deceive the public.[3] A bill was introduced, albeit unsuccess

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[1] For example, some gray market goods are diverted into the United States by U.S. companies, taking advantage of currency fluctuations. These monetary fluctuations have reportedly allowed importers to take advantage of discounts of 30% to 40%. See generally Strom, Enlisting the Copyright Law in Battling the "Gray Market," New York Times, D1, at D5 (July 21, 1992); Comment, The United States Customs Service's Regulation of Grey Market Imports: Does It Preserve the Broad Protections Afforded by Section 526 of the Tariff Act of 1930?, 5 Dickinson Journal of International Law 293, 293 (Spring 1987).

[2] Heon Hahm, Gray Market Goods: Has A Resolution Been Found?, 81 Trademark Rep. 58 (1991).

[3] Id. at 58. American trademark owners have generally argued that the flow of foreign goods identical to American goods

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fully, by Senator Orrin Hatch that was designed to prohibit the importation of all gray market goods into the United States.[4] Even so, action groups appear to persist in their efforts despite these early skirmishes with failure.[5]

Another driving factor that seems to push this area of concern to the forefront is that goods sold on the gray market in the United States are noticeably prevalent.[6] These specific goods include cameras, photographic equipment, cosmetics, soap, sporting goods, and more.[7] The diverted goods enter from a broad

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[3](...continued)
constitutes unfair trade practices and should be met with American legislation.

[4] On April 23, 1991, Senator Orrin Hatch (R.-Utah) introduced S 894 which would add a new Section to the Lanham Act, designed to effectuate this prohibition. See S 894, 102d Cong, 1st Sess (1991).

[5] Supra n.3 at 58.

[6] Gray market goods accounted for almost six percent of the trade deficit in 1984. Maks Westerman, The $7 Billion Gray Market: Where it Stops, Nobody Knows, Bus. Wk., Apr. 15, 1985, at 86. "Government and other experts say there are no reliable statistics on the size of the gray market." N.Y. Times, June 1, 1988, at 1. "Most estimates put it at below $10 billion a year in total sales." Id. at C6. Some have estimated the gray market to be as much as $100 billion. See A Red-Letter Day for Gray Marketeers, Bus. Wk., June 13, 1988, at 30. Cf James E. Inman, Gray Marketing of Imported Trademarked Goods: Tariffs and Trademark Issues, Am. Bus. Law Jnl., Vol. 1; No. 1; Pg. 9, May, 1993.

[7] D. Gilbert, Eugene A. Ludwig and Carol A. Fortine, Federal
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cross section of the United States' trading partner countries like Japan, Germany, Italy, France, the United Kingdom, Hong, Kong, and Singapore, to name but a few.[8] Furthermore, the monetary losses involved in the sales of gray market goods are enormous, with figures ranging from $5.5 billion to as much as $10 billion.[9] In spite of this, in recent years the gray market has noted a decline in the value of imports.[10] The ultimate challenge, however, of the gray market dilemma is to achieve an

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Trademark Law and the Gray Market: The Need for a Cohesive Policy, 18 Law and Policy in International Business 103, 109 (1986).

[8] Id. at 108.

[9] Experts disagree on the exact amount, however, the low-end figure is approximately $5.5 billion. Goodgame, Inside the Gray Market, TIME, at 76 (October 28, 1985). Another expert estimated $7 billion. Christer, Trade War Erupts in Gray-Market Goods, INC., at 19 (March 1986). Finally, the high-end estimate is set at $10 billion dollars total. Riley, Gray Market Fight Isn't Black and White, National Law Journal, at 70, col 3 (October 28, 1985). See also Paula Dwyer and Amy Dunkin, A Red-Letter Day for Gray Marketers, Bus Week 30, (June 13, 1988). See also Lansing, Paul; Gabriella, Joseph, Clarifying Gray Market Areas, Am. Bus. Law Jnl, Vol. 1; No. 2; Pg. 13, (September, 1993) citing Frank V. Cespedes et al., Gray Markets: Causes and Cures, 66 Harv. Bus. Rev. 75 (July-Aug. 1988). See also supra note 6.

[10] See Dollar Drop Drubs Grey Marketeers, Washington Post, at F3, col 3 (May 4, 1986).

acceptable balance between fair competition and free competition while maintaining the integrity of the trademark system.[11]

This situation is not limited to the United States. Gray market good are also a problem within the European Economic Community.[12] Price differences largely contribute to the trans-border shipments of goods - mostly pharmaceuticals. Thus, where these price differences exist, there will always be exporters and importers attempting to profit from the gray market situation.[13] However, the term "gray market" is not customary within the EC, rather, reference is made to "re-imports" or "parallel imports".[14] The European Economic Community manufacturers of the

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[11] See John A. Young, Jr., The Gray Market Case: Trademark Rights v. Consumer Interests, 61 Notre Dame Law Review 838, 853 (1986).

[12] See generally Hans-Christian Kersten, "Gray Market" Exports and Imports Under The Competition Law of The European Economic Community, 78 Trademark Rep. 479 (1988). (The European Economic Community ("EEC" or simply "EC") came into effect on January 1, 1958 and was created by the Treaty of Rome.)

[13] For example: When approved in May, 1976, fifty capsules of the drug ADALAT cost DM 16.26 (U.S. $9.29) in Germany and, at the then existing rate of exchange, DM 14.68 (U.S. $8.39) in Italy. Id. at 479.

[14] The term "re-imports" within the EC applies specifically to the situation where goods are shipped FROM Member State B to the place where they were first EXPORTED by the manufacturer, thence back into Member State A where they were in fact MANUFACTURED. The term "parallel imports" refers specifically to situations where goods are delivered through channels other than

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goods involved have tried repeatedly to prevent re-import or parallel import by invoking trademarks or other proprietary rights. These efforts, like those here in the United States, have also largely met with failure.

With the aforementioned in mind, this paper will follow the history of gray market goods in this country and the EC, describe the current theory of trademark ownership in both the United States and within the EC, as well as examine the present situation concerning gray market or parallel imports in both the United States and the EC. Finally, this paper will conclude with a comparison of the U.S. and EC situations and contrast the methods of protection afforded by both entities.

II. THE UNITED STATES' POINT OF VIEW

A. THE ROAD TO K-MART

1. The Traditional Theory of Trademark Protection

The traditional theory of trademark protection followed the "universality", or source theory. Under this theory, courts have

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those authorized by the manufacturer, from one country to another Member State C, where they ultimately compete with goods that were delivered to Member State C by the manufacturer. Both terms are used in reference to goods manufactured in Member State B by a subsidiary or licensee of the manufacturer and subsequently supplied to Member State A or a third State C without the manufacturers authorization. Id.

determined that a trademark is valid if it correctly identifies the *origin* of the goods or product, regardless of where the product is sold. Therefore, an owner of a trademark had no territorial title to an item, domestically produced or imported.

An example of the application of this principle can be found in the early, but well known case of **Apollinaris Co. Ltd., v. Scherer.**[15] There, an American owner bought the right to export Hungarian mineral water into the United States. The owner brought suit against an importer who had bought the water from the originator in Germany and subsequently sold it in the United States under the valid trademark. Apollinaris complained that it was unable to maintain its prices because the defendant was importing and selling the product in the United States at a lower price and therefore sought an injunction. The court examined the situation in a twofold manner.[16] Initially, they pointed out

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[15] Apollinaris Co. Ltd., v. Scherer, 27 F 18 (CC SDNY 1886).

[16] The Apollinaris court pointed out that the real question was whether the defendant, Scherer, was unlawfully interfering with any exclusive right that Apollinaris had with the water manufacturer/producer, Saxlehner, to control the sale of that water in the territory ceded to it by contract. If, indeed, that were the case, equity would have a place in their decision, and an injunction could issue. As they said, "equity is frequently invoked and always successfully to restrain unlawful competition in trade." Because, however, no such facts

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that the complaint was based in part on the theory that the defendant was infringing Apollinaris' trademark. However, because they found the goods to be the *genuine* article, there was no infringement. The court stated that it was not possible "by any contract...to create a territorial title to the products...[because] no such title is known to the law of personal property."[17] Furthermore, they said, a manufacturer had a right to dispose of his property as he saw fit. This led the court to the conclusion that "any purchaser [of a good or product], wherever he purchases it, acquires a valid title to treat it as his own property."[18]

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[16](...continued)
were proved, they largely dismissed the equity issue and based their dismissal of the injunction request on what has since become the "trademark exhaustion" principle. See generally Id. at 20. See also David Gladwell, The Exhaustion of Intellectual Property rights, 12 EIPR 366 (1986) and also Infra n.18.

[17] In essence, the point made was that "[t]here is no exclusive right to the use of a name or symbol . . . except to denote the authenticity of the article. . . ." This was so eventhough a contract between these parties existed. Thus, until the trademark "is sought to be used as a false token to denote that the product [] to which it is applied is the product [] which it [] properly authenticates, the law of trade-mark cannot be invoked." Supra n.15.

[18] A corollary has developed with the "universality" theory of protection known as "trademark exhaustion." Under this corollary owners lose control over their trademarked goods once the goods have entered the stream of commerce. Consequently,
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The focus by the courts, then, was upon the validity of the trademark and any contractual agreements then existing. Based on this theory, circumventing exclusive rights of distribution would not be considered as unfair competition because the property right originates in the *product*, not the territory in which it may be distributed.

In 1905, Congress passed the 1905 Trade-Mark Act which, in part, prohibited the importation of goods copying American trademarks. Specifically, it provided "[t]hat no article of imported merchandise... shall copy or simulate a trade-mark registered in...this act, 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 customs house...."[19]

In 1916, another case arose to test the "universality" or source theory of trademark protection. In **Fred Gretsch Mfg. Co.,**

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parallel importers may then display, advertise, and even resell those trademarked goods. Contrarily, however, some courts have held that the exhaustion principle does not apply when the domestic trademark holder has developed separate and independent goodwill. See generally J. Thomas McCarthy, 1 Trademarks and Unfair Competition 44 at 261 (Lawyers Co-op, 2d ed 1984).

[19] Trade Mark Act of 1905, ch 592, § 27, 33 Stat 730 (1905).

v. Schoening,[20] an American owner of exclusive distribution rights to a product sought injunction requiring the defendant to cease importation of the product obtained from the original owner. The case arose from the parallel importation of ETERNELLE violin strings from Germany. The distributor had attempted to exclude the parallel imports at Customs, under Section 27 of the 1905 Trade-Mark Act, which barred the importation of goods "copy[ing] or simulat[ing]" domestically registered trademarks.[21] The issue became whether Congress, by passing the 1905 Act, had intended to "protect the owner of a registered trade-mark against the importation by third parties of the genuine article...."[22] By their reading of the Act, the court found that the purpose of the Act was to protect the purchasing public and prevent the importation of products lacking *genuine* trademarks. The imported product in this case was in fact bearing a valid trademark and therefore "it is not infringed by one who buys...the *genuine*

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[20] Fred Gretsch Mfg. Co., v. Schoening, 238 F. 780 (CA 2 1916).

[21] Section 27 of the 1905 Trade-Mark Act now appears as § 42 of the Lanham Act, 15 U.S.C. §1124.

[22] Id. at 782.

article...imports it into the United States, and sells it so marked here."[23]

2. The Modern Theory of Trademark Protection

From these interpretations then, it can be seen that the "universality" or source theory of trademark protection is based upon a property interest concept that originates in the product itself--the tangible thing. In short, "universality" assumes that the trademark knows no territorial bounds and that the owner of the trademark possesses the trademark rights to the exclusion of everyone else in the world.[24] This view, that the mark "merely protect[s] the public from deception by indicating 'the origin of the goods the mark,'"[25] though once widely held, is contrary to the modern theory of "territoriality" wherein the impetus of protection lies in the product's more intangible elements--namely goodwill and development of market share.[26]

The previously accepted "universality" or source theory of protection for trademarks was to continue, however, until 1923

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[23] Id. (emphasis added).

[24] Osawa & Co. v. B & H Photo, 589 F. Supp 1163, 1171 (SD NY 1984).

[25] K Mart, 486 US at 301, citing A. Bourgois & Co. v. Katzel, 275 F.2d 539, 543 (2d Cir 1921).

[26] Supra n.19.

when the United States Supreme Court heard **A. Bourjois & Co. v. Katzel**.[27] **Katzel** concerned the rights of the Bourgois Company, which, in 1913, had purchased the United States trademark and distribution rights for JAVA face powder from the French manufacturer - also called Bourgois. The manufacturer of the face powder had been doing business in the United States for over thirty years. The United States distributor was thus in a position of exploiting the reputation of a product which was already known by the American consumer. For several years, the American Bourgois company built the business further, importing the powder from France and packaging it in boxes bearing the assigned trademarks.

A third party, Anna Katzel, soon discovered that favorable exchange rates allowed her to buy the identically marked product from French retailers, import it into the United States at a profit. The Bourgois Company brought suit, claiming that Katzel's sales of the identically marked face powder was infringing on Bourgois' American trademark rights.

Previously, the Second Circuit in **Gretsch** had ruled against the American trademark holder based upon the then existing

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[27] A. Bourjois & Co. v. Katzel, 275 F. 539 (CA 2 1921), rev'g 274 F. 856 (SDNY 1920), rev'd 260 U.S. 689 (1923). Hereinafter referred to as Katzel.

"universality" or source theory, holding that the *genuine* goods imported by the third party importer did not infringe the American owner's rights.[28] This came as a reversal of the district court's previous ruling that the American trademark owner *could* establish domestic goodwill in the market.[29]

The U.S Supreme Court, however, approved of the territoriality principle set out by the district court by overruling the Second Circuit. Specifically, the Court found that mere *ownership* does not convey *unrestricted* rights to sell wherever desired. Thus, they rejected the "universality" or source theory and recognized a less tangible interest in reputation and business goodwill which arises from a market share or presence.[30] Furthermore, they added, the American owned portion of the

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[28] See 275 F. 539 at 543.

[29] See 274 F. 856 at 857-859.

[30] See 260 U.S. 689. In Justice Holmes' opinion of this case he noted several facts that led him to this conclusion. Specifically pointed out were the facts that: The plaintiff had purchased the business for a costly sum; made independent decisions about the business that the plaintiff had bought; expended "much money in advertising;" and taken care in selecting colors "suitable" for an American market, in the packaging, and in "keeping up the standard." These were salient facts that the district court had also considered important. In light of this stance, one can see that Holmes rejected the circuit court's emphasis on common physical origin, thus embracing the district court's broader view which encompassed proprietary goodwill.

trademark "indicates in law, [and] by public understanding, that the goods came from the plaintiff although not made by it. It was sold with the *goodwill* of the business that the plaintiff [had] bought...."[31]

3. Mixing It Up

The stance by the lower courts reinforcing the "universality" or source principle caused Congress to enact Section 526 of the Tariff Act of 1922, which was later reenacted as section 526 of the Tariff Act of 1930.[32]

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[31] Id. at 692. (Emphasis added). It should be noted here that the distinguishing features in Katzel were twofold. First, that the domestic assignee - not the foreign predecessor - *owned* the U.S. trademark, and second, that the public *understood* that the *American distributor* - not the French manufacturer - was the *source* of the goods at issue. When combined with factual situations such as found in Katzel, it appears that this aspect - the "territorialist" feature of Holmes' law - would serve to preserve a private party's *control* over the ultimate disposition of their proprietary goodwill. This aspect was further defined in Prestonettes v. Coty, 264 U.S. 359 (1924). In Prestonettes, the emphasis was upon "truthfulness." There, genuine "Coty" products were purchased, and pursuant to a decree secured by both Prestonettes and Coty, the goods were purchased, repackaged and sold with a disclaimer noting that the primary ingredient belonged to Coty and that Prestonettes was in no way connected with Coty. Justice Holmes found no infringement and added that the mark was indeed used in such a way that it did not deceive the public. This stance by Holmes appears to take Katzel one step further by expanding the definition of, as Holmes had put it, the "public understanding" of where the trademark had originated.

[32] Tariff Act of 1930 § 526, 19 U.S.C. § 1526 (1986). A (continued...)

Section 526 of the Tariff Act of 1930 provides generally that it shall be unlawful to import "any merchandise of foreign manufacture if such merchandise...bears a trademark owned by any citizen of..or corporation or association...organized within the United States...unless written consent of the owner...is produced at the time of making entry."[33] It should be noted that the statute, while allowing a United States trademark owner the right to prohibit entry of foreign goods, is not clear as to whether this right applies only when the foreign manufacturer is an independent company or whether the United States trademark owner can exclude importation of the goods which originate with a related foreign company.[34]

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[32](...continued)
review of the legislative history will reveal that Congress refers specifically to Katzel. They note that "[a] recent decision of the circuit court of appeals holds that existing law does not prevent the importation of merchandise bearing the same trade-mark as merchandise of the United States, if the imported merchandise is genuine and if there was 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; . . . ." For more detail see HR Rep No 1223, 67th Cong, 2d Sess 158 (1922).

[33] 19 U.S.C. § 526 (1982).

[34] This portion of the legislation is discussed at length in Vivitar v. United States, 593 F.Supp 420, 426-28 (CIT 1984), affd 761 F.2d 1552, 1561-65, 225 USPQ 990 (CAFC 1985).

However, the force of the complaints concerning gray market or parallel imports arising under Section 526 is grounded in claims that the Customs regulations exceptions in Section 133.21 were inconsistent with the statute. Section 133.21 of the Customs regulations provides exceptions to the entry of unauthorized goods imported by companies related to or authorized by an American trademark owner.[35] Generally, it provides exemptions in three areas; The restrictions do not apply to imported articles when: (1) Both the foreign and U.S. trademark are owned by the same person or entity, (2) The foreign and domestic trademark owners are parent and subsidiary or otherwise subject to common control, or (3) The articles of foreign manufacture bear a recorded trademark applied under authorization of the U.S. owner.[36] This controversy has been examined in a variety of cases, particularly **Vivitar Corp.**[37] and **Olympus Corp.**[38]

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[35] See generally 19 CFR § 133.21(c)(1)-(3) (1987).

[36] Id. Section 133.21(c)(3) was recently struck down by the United States Supreme Court in K Mart Corp v. Cartier, Inc., 486 U.S. 281 (1988).

[37] Vivitar Corp v. United States, 761 F.2d 1552 (CAFC 1985).

[38] Olympus Corp v. United States, 792 F.2d 315 (CA 2 1986).

Vivitar Corp. was a major producer of photographic equipment and the owner of the trademark VIVITAR. Most of its products were manufactured in Japan. Its distribution system was such that the parent corporation sold in the United States, with foreign subsidiaries selling abroad. Third party importers were purchasing Vivitar equipment abroad from Vivitar's licensees and importing the items into the United States at a lower cost. Vivitar accused the discount houses of obtaining a free ride which would eventually erode the reputation and sales value of the VIVITAR mark.[39]

Before the district court Vivitar argued that Section 526 gave it an absolute right to require Customs to prevent the importation of foreign manufactured goods bearing the trademark VIVITAR, and that the regulations granting an exception without the consent of the owner were invalid.

Muddling through Congressional intent and legislative interpretation, the court concluded that the Customs regulations simply defined the role of Customs in initiating administrative enforcement of the statute. In light of this, they held that Customs was not required to exclude all gray market goods sua

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[39] Vivitar Corp. v. United States, 761 F.2d 1552, 1556.

sponte.[40] Furthermore, while a reasonable exercise of Customs' power was to exclude, the regulations did not define the limits of protection afforded a trademark owner. As to Vivitar's second claim, the court held that since Congress could not have foreseen all possible international trade relationships, it must also reject any contentions that any limitations on the statute were invalid.[41] Essentially, then, they found that while Customs had, at the outset, promulgated broad regulations interpreting section 526, by 1936 they allowed the entry of goods if "such [a] foreign trade-mark [] [is] owned by the same person, partnership, association, or corporation."[42] The thrust of the regulations had remained essentially unchanged since 1936, essentially denying an American trademark owner the right to prohibit the importation of foreign manufactured goods bearing its trademark whenever the United States trademark owner controls the source of the foreign goods. Ultimately, they concluded that section 526(a) was enacted "as a special remedy to protect American

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[40] Id. at 1569.

[41] Id. at 1570.

[42] Supra n.39 at 427.

businesses that purchase foreign trademarks from imports that violate the rights of the American businesses purchase."[43]

On appeal, the Federal Circuit narrowed the district court's holding. They agreed that Customs regulations are a reasonable exercise of Customs' power, however, they emphasized that these interpretations are not the sole protection afforded a United States trademark holder under section 526.[44] The Appeals Court also found that Congress had intended that section 526(a) provide a broader exclusion remedy than the one found in section 27 of the Trade-Mark Act of 1905. Thus, they added, no limitations could be read into section 526.[45]

The **Olympus**[46] scenario largely entailed similar factual circumstances. Olympus Corporation was the owner of the United States trademark OLYMPUS and the exclusive distributor of Olympus

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[43] Id. at 435.

[44] 761 F.2d at 1555. They added that the trademark owner is free to seek judicial determination as to the issue of whether or not the goods may be excluded. If so, Customs must exclude them - regardless of the relationship between the entities.

[45] Id. at 1565. Ultimately, the Appeals Court went on to uphold the validity of the Customs regulations, with the caveat that the regulations did not limit the United States trademark owner's right to pursue a private cause of action.

[46] Olympus Corporation v. United States, 792 F.2d 315, 230 USPQ 123 (CA 2 1986).

optical's Japanese manufactured goods in the United States. The goods involved included cameras, lenses, flash units, and filters. 47th Street Photo, Inc. was a New York retailer of electronic equipment that purchased some of Olympus' merchandise, apparently at prices that would allow 47th Street Photo to offer the goods for resale in its stores at discount prices.[47]

The Second Circuit noted that the applicable Customs regulation, specifically section 133.21, allowed for an exception from Customs' seizure under section 526 for imported articles bearing a trademark identical to one held by a United States corporation when certain conditions were met.[48] The court largely adopted by reference the Vivitar discussion concerning the history of the Customs regulations.[49] However, the Second Circuit held that Congressional acquiescence in the interpretation of the statute legitimated the interpretation as an exercise of Customs enforcement discretion.[50] Also, seemingly in line with **Vivitar**, the

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[47] Id. at 317.

[48] Id. Specifically, the Court allowed that the exception in section 133.21(c)(2) permitted foreign and domestic corporations that are parent and subsidiary or otherwise subject to common control to remain exempt and import goods without permission of the mark owner.

[49] Id. at 319.

[50] Id. at 320.

court claimed that the Customs interpretation merely limited Customs' obligation to enforce the regulation by excluding certain goods. They, too, noted that the trademark owner still retained rights under Section 526 of the Tariff Act that could be pursued via private remedies, notwithstanding Customs' failure to exclude the goods.[51] Because of underlying administrative problems of Customs, the court was inclined to believe that Congress had engaged in legislative acquiescence.[52]

The combined result of these decisions was to ultimately uphold Customs regulations as valid exceptions to general prohibitions provided in Section 526. Also, apparently, it reminded trademark owners that there exists other avenues available to them in their ever increasing task of policing their trademarks at the border.

II. ARRIVAL AT K-MART - THE PROTECTION AFFORDED

1. The Current Definition of Gray Market Goods

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[51] Id.

[52] Id.

In a 1988 decision[53] the United States Supreme Court defined a gray market good as a "foreign-manufactured good, bearing a valid United States trademark, that is imported without consent of the United states trademark holder." The Court further identified three areas where gray market controversies primarily arise. The first situation occurs when a domestic firm purchases from an independent foreign firm the rights to register and use the foreign firm's trademark as a United States trademark and to sell its foreign-manufactured products stateside. The foreign firm (or a third party who bought from the foreign firm) then imports the trademarked goods for sale, despite having sold the trademark to a domestic firm. Thus, the domestic firm is forced into competition involving the very trademark it had just purchased rights to (case 1). The second situation occurs when a trademark is registered in the United States by a domestic firm which is a Subsidiary (commonly called case 2), a Parent (called a case 2(a)), or a Division (case 2(b)) of a foreign manufacturer

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[53] K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 285. (On December 8, 1986, the Supreme Court granted petition for writs of certiorari in COPIAT, re: United States v. Coalition to Preserve the Integrity of American Trademarks, 107 S.Ct. 642 (1986), and two companion cases, 47th Street Photo, Inc. v. Coalition to Preserve the Integrity of American Trademarks, et. al. and the now cited case of K Mart Corp. v. Cartier, Inc. (hereinafter referred to as "K Mart").

or firm, and goods bearing the same trademark are imported into the U.S. by a third party. The third context arises when the domestic holder of a United States trademark authorizes an independent foreign manufacturer to use the mark and subsequently the foreign manufacturer or a third party imports the foreign made goods (case 3).[54]

In **K Mart**, the issue before the Supreme Court became whether the regulation permitting the importation of certain types of gray market goods, 19 CFR § 133.21 (1987), was a reasonable interpretation of § 526 of the Tariff Act of 1930.[55] The Court examined the three scenarios described above which, under Customs regulations, allowed gray market goods to be imported into the United States. Of these three, the third scenario, the authorized use exception ((case 3), authorizing a foreign manufacturer to produce abroad but not to import into the United States), was abolished on the grounds that it was in conflict with the plain meaning of the statute.[56] Specifically, the Court found that subsection (c)(3), 19 CFR § 133.21(c)(3) (1987), "denies a domestic trademark holder the power to prohibit the importation

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[54] Id. at 286, 287.

[55] Id. at 285.

[56] Id. at 294.

of goods made by an independent foreign manufacturer where the domestic trademark holder has authorized the foreign manufacturer to *use* the trademark."[57] The Court reasoned that if the statute is clear and unambiguous, the courts must give deference to Congressional intent. However, if the statute is silent or ambiguous with reference to a specific issue, the courts must give deference to the agency's interpretation--*if it does not conflict with the statute's plain meaning.*[58] Having found a conflict with the plain meaning, they struck down the authorized use exception (case 3). Alternatively, the Court emphasized that Customs' interpretations in cases 1 and 2 (regulations allowing the imports from companies under common control to enter the United States) were consistent with Section 526 and therefore valid.[59]

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[57] Id. (Emphasis added).

[58] See generally Id. at 291-292.

[59] See generally Id. at 292-293. This portion of the Court's holding was based upon sound reasoning. As explained by Justice Kennedy, the term "owned by" was found to be sufficiently ambiguous in that it applied to situations involving a foreign parent corporation (case 2(a)). The ambiguity, it seemed, arose from the inability to discern from the statute *which* of the two entities involved was the "owner" of the trademark. Further, Kennedy pointed out, the phrase " merchandise of foreign manufacture" was also ambiguous in that it was possible to interpret it to mean (1) goods manufactured *in* a

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This appears to be in conflict with the current theory of territoriality, as well as other United States legislation.[60] The decision in **K Mart** apparently carves out an exception when applied to multinational corporations. The Court seems to indicate that property interests in the trademark are *universally* owned when held by multinational corporations. Since goods that are manufactured by affiliate companies are not to be barred entry under Section 526, American companies will have to resort to other means of protection for their trademark. In short, the American trademark owner abroad must either attempt to somehow distinguish his goods from those identically trademarked goods that are being imported via gray marketers, or seek legal avenues of redress that have been established for gray market imports that arise in the context of affiliated companies.

2. **Lanham Act claims**

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[59](...continued)
foreign country, (2) manufactured *by* a foreign company, or (3) manufactured *in* a foreign country *by* a foreign company. It was precisely because of that imprecision that the agency - here Customs - was allowed to choose *any* reasonable definition that did not conflict with the plain meaning of the statute.

[60] See generally Section 42 of the Lanham Trademark Act, 15 U.S.C. § 1124 (1992).

Lanham Act claims arising under Section 42 were not specifically addressed by the K Mart Court.[61] To the extent that the Lanham Act pertains to domestic market interests though, gray market claims arising under the act may still be argued before the courts. The Lanham Act protection against gray market goods closely parallel the territoriality theory of protection of the relationship between goodwill of the trademark holder and the consumer. To the consumer, the trademark represents the company's good name, reputation and promise of quality. Thus, they can justify a higher cost paid for these intangible extras. However, gray market imports damage this reputation and goodwill by divesting the trademark owner of what was once rightfully theirs--sometimes to the direct detriment of the consumer.

Some jurisdictions adhering to the universality theory of protection, however, dismiss Lanham Act claims because they argue that the act applies only to counterfeited trademarks and not to the genuine articles.[62] Others, favoring the territoriality theory, have construed the marks to be unauthorized copies because they hold themselves out as authorized goods but fail to

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[61] 15 U.S.C. § 1124 (1982). See specifically 486 U.S. 281, at 290, n.3, where the Court dismissed without discussion the issues of Lanham Act protection as not before the court.

[62] See, eg, Olympus Corp, 792 F.2d 321.

provide the consumer the same quality usually received via the authorized goods presented in the marketplace.[63]

Lever Brothers was a case decided more recently and after the **K Mart** decision. There, two affiliated corporations, one U.S. based, the other in the U.K., used the same words, Shield and Sunlight, as trademarks for products that differed materially in the two countries. The products differed because the manufacturers had adjusted the qualities of the product to suit the countries' differing conditions. These disparate qualities caused the products to perform differently under normal usage conditions. For example, the Shield soap made in the United Kingdom contained a lower concentration of fatty acids and a higher concentration of coconut soap which caused it to lather more quickly. The United Kingdom brand apparently lacked those qualities when used in American water. Third parties were acquiring the United Kingdom articles and importing the products into the United States. The parties had stipulated that the two companies were subject to common control, thus eliminating any claim under 19 CFR § 133.21(c)(2) (1988).[64] In support of its

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[63] See generally Katzel, 260 U.S. 689.

[64] See Lever Brothers Co. v. United States, 877 F.2d 101 (1989) at 102, n.1, remanded to 796 F.Supp 1 (1992) affirmed in (continued...)

request for preliminary injunction, Lever submitted numerous letters from consumers expressing concern over what they perceived as a discounted version of the usual product that had failed to perform to their satisfaction. Their claim was based upon Customs' duty to seize such imports on § 42 of the Lanham Act of 1946.[65]

Section 42 provides generally that "no article of imported merchandise which shall copy or simulate the name of any domestic manufacture [] 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...."[66] Notwithstanding affiliation, Lever argued, the differing physical content amounted to copying under Section 42 and therefore should be denied importation.[67]

The court first reviewed 19 CFR § 133.21 (1988), as well a the decision reached by **K Mart** in an attempt to resolve this issue. First, they noted that **K Mart** had struck down subsection

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[64](...continued)
part, vacated in part, 981 F.2d 1331 (1993).

[65] 877 F.2d 101 at 103.

[66] 15 U.S.C. § 1124 (1982).

[67] See 877 F.2d 101 at 103,104.

(c)(3), the authorized use exception, then turned to the critical subsection (c)(2), the affiliate exception. The court pointed out that in addition to being upheld in **K Mart**, an additional regulation, 19 CFR § 133.12(d) was in effect to aid in the enforcement of § 133.21(c)(2). The enforcement subsection required that applications to record a trade name with Customs list affiliates using the name abroad, which Lever had previously done.[68] Where the affiliate exception existed, they said, Customs could regard as irrelevant both physical differences in the products and the markholder's non-consent to importation.[69]

The court barely touched on the issue of Customs' interpretation of Section 42 of the Lanham Act, tentatively reaching the "view that the Service's construction of § 42 defeats its purpose and is therefore contrary to its intent."[70] After a searching explanation of the history of the affiliate exception, the court remanded the case for further findings. Eventually, it ended back in their court and was finally decided in 1993.

In 1993 the Appeals Court reiterated that in Lever I, they concluded that Section 42 does bar foreign goods bearing a

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[68] Id. at 104, nn.4 & 5.

[69] Id. at 104.

[70] Id. at 105.

trademark identical to a valid U.S. trademark, but physically different, without regard to affiliation. They arrived there by applying a two part test developed in **Chevron U.S.A. Inc.**[71] Specifically, (1) if Congress has clearly expressed intent, the courts will give it deference, (2) if ambiguity exists, courts accept the Customs' interpretation provided it is reasonable.[72] Thus, the specific issue before the court was whether the intended prohibition of Section 42 admits of an exception for materially different goods made by a foreign affiliate.[73]

A thorough examination of the legislative history and administrative practice up and through Section 42 of the Lanham Act revealed that "nothing in the record concerning the Lanham Act indicat[ed] that Congress contemplated--much less intended to allow--an affiliate exception."[74] The court continued its examination of developments since the passage of the Lanham Act finding that although several attempts were made to enact an affiliate exception, Congress repeatedly failed to enact it.

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[71] Chevron U.S.A., Inc. v. NRDC, 467 U.S. 837 (1984).

[72] Lever Bros. Co. v. U.S., 981 F.2d 1330, 1331 (1993) citing Chevron U.S.A., Inc. v. NRDC, 467 U.S. 837, 842-43 (1984).

[73] 981 F.2d at 1333.

[74] Id. at 1337.

They noted, however, that the Treasury Department had, in 1972, adopted the exception in the form of **19 CFR § 133.21(c)**. The adoption of the affiliate exception in this form in effect rendered Section 42's protection inapplicable they said.[75] Customs argued that regardless of whether or not the goods were identical, a mark applied by a foreign firm subject to ownership and common control of a domestic firm is a genuine mark. Therefore, any importation of those goods cannot infringe because the goods are ipso facto genuine.

The argument failed to sway the court. Trademarks applied to physically different foreign goods are not genuine from the viewpoint of the American consumer, they said. The intent of Section 42 was to prevent deceit and consumer confusion and the fact of affiliation in no way reduces the probability of that confusion. With this in mind, the court concluded that Section 42 of the Lanham Act, 15 U.S.C. § 1124, precluded the application of Customs' affiliate exception with respect to physically, materially different goods.[76] Thus, physically different foreign goods bearing a trademark identical to a valid U.S. trademark, regardless of the trademark's genuine character abroad or affil-

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[75] Id. at 1338.

[76] Id. at 1340.

iation between the producing firms, were to be barred entry under Section 42 of the Lanham Act.

III. CONCLUSION OF THE UNITED STATES' PERSPECTIVE

1. Gray Market becoming Black

In light of **K Mart** and **Lever** (as it stands today) the future for gray market imports is beginning blacken. **K Mart** erased the authorized use exception when applied to imports. **Lever** apparently erased the affiliated use exception, albeit only in areas of physically, materially differing goods and also apparently limited for now to the D.C. Circuit. **Lever** takes a step toward turning the Gray Market business into a Black Market business. Variations will continue to be seen, but generally, it can be said that the differing interpretations of the Lanham Act protection against gray market goods will depend largely upon whether the court will examine trademark interests as arising from the goodwill of the mark. If this is the case, courts will generally uphold Lanham Act prohibitions under the current territoriality theory of protection. If the contrary view is taken, namely that the court focuses on the authenticity or genuineness of the mark, the court will generally dismiss Lanham Act claims under the

older, more traditional theory of protection.[77] **Lever** seems to have taken a large bite out of that interpretation, though. At least, it would seem, when the goods themselves are of physically, materially different qualities. On those occasions trademark owners should be able to argue a successful Section 42 claim and seek denial of importation of those goods.[78]

IV. THE EUROPEAN ECONOMIC COMMUNITY POINT OF VIEW

Even the European Economic Community (EC)[79] cannot escape gray market goods in spite of the fact that the term "gray market" is not customary.[80] Naturally, manufacturers of these

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[77] See infra, n.15 for a discussion concerning the "universality" or source throry of protection. Generally, this theory held that there could be no infringement if the goods involved were identified by a trademark that correctly identified the origin of the goods - regardless of where the goods were sold.

[78] See generally Lever Bros. Co, 981 F.2d 1330ς

[79] See supra n.11.

[80] Rather than use the term "gray market" the EC refers to "re-imports" in the case in which goods are shipped from Member State B, to where they were manufactured. An additional term, "parallel imports" is used in the case where goods delivered through channels other than those authorized by the manufacturer from the country to another Member State C, where they compete with the goods delivered there directly by the manufacturer. Finally, both "re-imports" and "parallel imports" are used in reference to goods manufactured in EC State B by a subsidiary or licensee of the manufacturer and subsequently are supplied to Member State A without the manufacturer's permission. See

(continued...)

goods attempt to prevent the subsequent re-import or parallel import by invoking the protection of their trademark - their Intellectual Property Right.[81] Unfortunately, as appears to be the case here in the United States, the efforts within the EC appear to be only moderately successful in the battle against gray market goods.

A. THEORIES OF PROTECTION UNDER THE EC TREATY

The cornerstone of the free trade policy of the EC is the principle of free movement of goods. It is upon this principle that the "right" to make parallel imports is based. It is paramount, therefore, to understand that the term "parallel importation" includes not only the import of goods back into the Member State (State A) where the goods originated, but also the import of goods into another Member State (State B) of goods that were obtained in Member State A.[82]

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[80](...continued)
generally supra n.11.

[81] These "Intellectual Property Rights" (IPR) are intended to give protection against competition with rival enterprises and thereby promote economic progress by providing an incentive for innovation and creativity.

[82] Id.

The principle of free movement of goods is embodied within certain provisions of the Treaty of Rome[83] (Treaty) and includes goods, services, persons, and capital (the so called four fundamental freedoms). The provisions within the Treaty, specifically Articles 30 - 36, are frequently raised in attempts to protect manufacturers against the tide of gray market goods within the EC. Specifically, Article 30 of the EEC treaty provides that:

> Quantitative restrictions on imports and all measures having equivalent effect shall, without prejudice to the following provisions, be prohibited between Member States.

Article 36 goes on to add that:

> The provisions of Articles 30 to 34 shall not preclude prohibitions or restrictions on imports, exports or goods in transit justified on grounds of public morality . . . or the protection of industrial and commercial property. Such prohibitions or restrictions shall not, however, constitute a means of arbitrary discrimination or a disguised restriction on trade between member States.

It should be noted that the free movement rules, as well as

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[83] See supra n.11.

the related "exhaustion doctrine" (which will be discussed later) relate only to imports and exports between Member States and generally does not extend to the importation of goods from countries outside the EC.[84]

B. PARALLEL IMPORTS AND TRADEMARKED GOODS

A noted case involving parallel importation of trademarked goods (as well as patented goods) is that of **Centrafarm v. Sterling Drug.**[85] Sterling Drug owned parallel patents for a drug in Great Britain and the Netherlands. It granted manufacturing and distribution licenses to its British subsidiary - Sterling-Winthrop - for Great Britain. It had also granted a distribution license to its Dutch subsidiary - Winthrop B.V. - for the Netherlands (which was purchasing its drugs from Great Britain). Both of the subsidiaries were registered owners of the trademark NEGRAM within their own countries. At the time in question, the

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[84] See EMI Records v. CBS UK, ECR 811 where COLUMBIA trademark owned by EMI Records in all Member States. The European Court of Justice held that EMI could rely on its trademark to prevent the marketing of records and tapes from a non-EC country (The U.S.) bearing the identical COLUMBIA mark.

[85] Centrafarm v. Sterling Drug, ECR 1147 (European Court October 31, 1974). See also Centrafarm v. Winthrop, ECR 1183 (European Court October 31, 1974). Centrafarm owned both the patent for the goods involved, here drugs, as well as the trademark for those goods. In this instance, we will deal solely with the trademark issues.

drug was sold in Great Britain for roughly half the price of the same drug in the Netherlands. A Dutch company, Centrafarm, purchased major quantities of the drug from Sterling-Winthrop (in Great Britain and at half the price it would have cost in Netherlands) and marketed them (for the resulting profit) in the Netherlands. The Dutch subsidiary, Winthrop B.V., brought suit, invoking its trademark IPR, to have the practice forbidden. The European Court found that, although Article 36 guarantees the "existence" of industrial or commercial property that is granted by the legislation of a particular Member State, its "exercise" could well be affected by the prohibitions within the Treaty. Furthermore, being an exception to one of the fundamental four freedoms of the Common Market, Article 36 only allows restrictions on the free movement of goods to the extent that the restrictions are justified to safeguard the rights that constitute the "specific subject matter of the property."[86]

The Court went on to define "specific subject matter" of a trademark as one that gave the owner of the trademark the exclusive right to put the product into circulation using that trademark and to protect him against competitors that sought a free

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[86] Id. at 1162 and 1194 respectively.

ride by taking advantage of the status and reputation of the mark by selling goods that bore the mark illegally.[87]

The Court further added that it could prove obstruction to the free movement of goods as defined in Article 36 if the rights of the owner were not "exhausted" by placing the goods into the stream of commerce of any other Member State.[88] In short, an owner of an Intellectual Property Right, such as with a trademark, cannot rely upon that right to prevent importation of a product lawfully marketed elsewhere within the EC by the owner or with her consent or by a person connected with her by ties of legal or economic dependence. Thus, because it had been difficult to determine whether the exercise of an Intellectual Property Right is in fact justified for the purposes of protecting the

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[87] See also Roche v. Centrafarm, ECR 1139 at 1168 (European Court May 23, 1978). In **Roche**, the Court decided that the main function of a trademark was to offer a "guarantee of origin" on the basis of which consumers could be sure that a labelled product had not undergone any alterations. Specifically, the said that the right granted to every trademark owner to oppose every use of the trademark which could falsify this guarantee of origin was declared to be a part of the "specific subject matter" of trademark rights.

[88] In some Member States, the exclusivity rights that flow from the trademark are already exhausted by the national law of that Member State, EVEN IF the owner of the mark (or an authorized third party) puts the goods into circulation not in a territory covered by the trademark, but rather in another country. See especially Centrafarm v. Sterling, supra n.71.

"specific subject matter" of the trademark, the Court has in recent decisions tended to rely upon the exhaustion doctrine.

In efforts to further the principle of free movements of goods within the EC, even in the face of national proprietary rights, the Court at one time did not appear to have restricted itself to the requirement of approval or "consent" by the owner of the Intellectual Property Right for the goods being put into circulation in another Member State. Rather, it appears to have been sufficient at a previous time that the goods were put into circulation in the other Member State under a trademark or logo of identical origin.

An early example of this can be seen in the case of **Sirena v. Eda.**[89] There, an Italian cosmetics manufacturer owned the trademark PREP in Italy. In Germany, the same mark was owned by an American company, Mark Allen. Mark Allen had initially been the owner of the mark in Italy, but had transferred it to the Italian manufacturer. The European Court decided that the Italian manufacturer could not forbid the importation of cosmetics bearing the same trademark from Germany for the very reason that there, it belonged to the American company.

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[89] Sirena v. Eda, ECR 69 (European Court February 18, 1971).

Similarly, in the case of **Van Zuylan v. Hag**[90] the European Court decided that the owner of the HAG trademark for coffee in Belgium and Luxembourg could not prevent a German coffee manufacturer, Hag AG, from importing its coffee into Luxembourg under its own German trademark. The Court noted that the reasoning for this was that Van Zuylan had acquired its mark in 1971 from the Belgian company Cafe Hag S.A. Originally the mark belonged to a German company, Hag AG, which licensed its Belgian subsidiary to use the mark in Belgium and Luxembourg. In 1944 it was confiscated as enemy assets by Belgian shareholders and the assets, as well as the Belgian HAG trademark were held by the Belgian government. Ownership was ultimately transferred to a independent Belgian enterprise having no links with Hag AG. Hag AG was eventually allowed to rely upon the Community principle of free movement of goods to enable it to market in Belgium its German coffee bearing the similar German mark. Additionally, in view of the "common origin" of the mark, as well as the "exhaustion doctrine", the Court held that the Belgian owners could not rely upon their mark to prevent the import.

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[90] Van Zuylan v. Hag, ECR 731 (European Court July 3, 1974).

Recently, however, the decision in Hag ("Hag I") has been reversed by the Court's decision in **CNL-Sucal v. Hag GF** ("Hag II").[91] In Hag II, the Court recognized the importance of trademarks as a guarantee of origin and quality. Here, the Belgian coffees and the German Hag coffees were of a noticeably different taste. Even though sold under identical marks, they said, consumers could be confused as to which was which. Thus, on this basis, justifiable unfair competition, the Court granted an injunction to import coffee from Belgium into Germany.[92] Furthermore, the Court ruled that in determining whether a trademark right has been exhausted, the decisive criterion is consent. They noted that, "where the mark originally had one owner and where the single ownership ended as a result of expropriation, each of the owners of the trade mark right must be able to prevent the importation and marketing, in the Member State where the mark belongs to him, of products originating from the other owner, if they are similar products bearing a mark which is identical or which may cause confusion."[93]

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[91] CNL-Sucal v. Hag GF, 3 CMLR 571 (1990).

[92] Note that this is the reverse of Hag I where importation was prohibited from Germany into Belgium.

[93] Supra n.90 at 609.

The Court in Hag II also addressed the issue of the aforementioned "specific subject matter" of the Intellectual Property Right. They noted that the specific subject matter of the right is "to grant the owner the right to use the mark for the first marketing of a product and, in this way, to protect him against competitors who would like to have the position and reputation of the mark by selling products to which the mark has been improperly affixed."[94] Furthermore, thy added that "[t]o determine the exact effect of this exclusive right which is granted to the owner of the mark, it is necessary to take account of the essential function of the mark, which is to give the consumer or final user a guarantee of the identity of the origin of the marked product by enabling him to distinguish, without possible confusion, that product from others of a different prominence."[95] Thus, a guarantee of origin assures a guarantee of quality known to the consumer.

C. PARALLEL IMPORTS FROM NON-EEC COUNTRIES

The EC's use of Articles 30 and 36 of the EEC Treaty has not always been limited to import or trade restrictions between EC Member States. Attempts have been made by trademarks owners to

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[94] Id. at 608.

[95] Id.

use these Articles in establishing trade barriers existing on the basis of Intellectual Property Rights between the Common Market and non-Common Market countries. As can be seen, however, the Court has frequently held the application of the Articles to be inapplicable in these situations.

This was illustrated in the case of **EMI v. CBS.**[96] Here, the American records company, CBS, was importing records under the trademark COLUMBIA into Great Britain from the United States. Additionally, CBS was engaged in producing records in Great Britain via a CBS subsidiary. The trademark in question, COLUMBIA, was conflicting with the same mark which was owned and used in Great Britain by EMI (also COLUMBIA). Both marks had been previously owned by the same American owner, with the British trademark being transferred to the American's British subsidiary in 1917.[97]

The European Court of Justice decided that EMI's exercise of its trademark right to oppose the importation of CBS records under the trademark COLUMBIA to Great Britain from the United

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[96] EMI Records v. CBS UK, ECR 811 (European Court June 15, 1976).

[97] Id. The British subsidiary was eventually sold to EMI in 1931. The American trademark owner eventually ended up at CBS in 1938.

States (or their manufacture by the CBS subsidiary in Great Britain) did not impair the free movement of goods between the Member States and was, therefore, not subject to the prohibitions of Articles 30 and 36 of the EEC Treaty.[98] The situation would only be different if the existence of a trademark right appeared to be the subject matter, means or consequence of an agreement or concerted practice in restraint of trade aimed at or resulting in the external isolation or internal sealing-off of the Common Market.[99] Thus, barring such "concerted practice" EMI could rely on its trademark right to prevent the marketing of records and tapes from non-EC countries (the United States) bearing the identical COLUMBIA mark.

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[98] Id at 848. The court also noted that this was true even though the action might represent a "measure having the equivalent effect of a quantitative restriction" adding, that the unity of the Common Market which these articles are intended to safeguard was not compromised by such existence of a trademark right. Even so, the Court has felt it only necessary to consider the national law of the European country of import in question. For example, under Section 4(3)(a) of the United Kingdom Trade Marks Act 1938, if "the proprietor or the registered user conforming to the permitted use had applied the trade mark...or has at any time expressly or impliedly consented to the use of the trade mark," others who deal in those goods are not infringers. Cf Colgate-Palmolive v. Markwell Finance, RPC 497 (1989).

[99] Id. at 850.

Another case concerning parallel imports from outside the EEC can be seen in **Revlon v. Cripps & Lee.**[100] Here, Revlon Inc., the parent company, distributed REVLON FLEX shampoo in the United States. The goods entered the United Kingdom via a parallel importer. The proprietor and registered user of the parallel United Kingdom mark (a subsidiary of Revlon, Inc.) were held to have impliedly consented to the use of the mark and, therefore, were unable to rely upon the IPR of the mark to prevent the import of the American made shampoo.[101]

D. THE EXHAUSTION OF RIGHTS WITHIN THE EEC

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[100] Revlon v. Cripps & Lee, FSR 85 (1980). See also Colgate-Palmolive v. Markwell Finance, RPC 497 (1989).

[101] This seems to confirm the existence of a principle of international exhaustion - at least in respect to United Kingdom registered trademarks. In a separate case, Colgate-Palmolive v. Markwell Finance, FSR 85 (1980), the United Kingdom proprietor was considered not to have consented to the import into the U.K. of toothpaste marketed by its Brazilian subsidiary and bearing identical marks. Thus, the rights in the U.K. were not exhausted. The Court noted that the sale of the Brazilian toothpaste under the Colgate mark indicated not only origin, but also that the toothpaste conformed to an identifiable quality. The facts indicated that the quality of the Brazilian toothpaste was inferior. Based, in part, upon this, the United Kingdom trademark was found to have been infringed. See also Castrol v. Automotive Oil Supplies, RPC 315 (1983).

As has been noted under the exhaustion doctrine developed by the European Court[102], the owner of an IPR (Intellectual Property Right) cannot rely upon that right to prevent the importation of a product lawfully marketed elsewhere in the EC by the owner or with her consent or "by a person connected with [her] by ties of legal or economic dependence."[103] Thus, the first sale of the product, by or with the consent of the IPR owner or by an affiliate or licensee, exhausts the intellectual property rights for the whole Community. Subsequent free circulation, therefore, cannot be prevented by reference to those exhausted rights.[104]

In order to determine whether an IPR has been exhausted, two essential factors need be considered. First, did the IPR owner

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[102] Supra n.88.

[103] See CNL-Sucal v. Hag, supra n.91 at 607. See also n.98.

[104] See Centrafarm v. Sterling, supra nn.71 & 88. Note, however, that notwithstanding the exhaustion of these rights, if the parallel import in fact misleads purchasers, proceedings in passing off or unfair competition may be possible. Some authors add that the doctrine of exhaustion as merely an extension of the rule of national exhaustion to the Community as a territory. foe example, if the rights of an IPR owner are exhausted within a national territory following the sale in that territory, the IPR owner also should not be able to prevent the import of those goods from other Member States - doing so would, in essence, be discriminatory. For an elaboration see Laurence J. Cohen and Adam N. Cooke, How Trademarks and other Rights may be used to limit Parallel Imports in Europe, 81 TMR 371, (July, 1991 - August, 1991).

give "consent" to the first marketing of the trademarked product in a Member State?[105] Second, are the property rights parallel, re: do they give the same level of protection in the Member States involved? If so, are they capable of exhaustion?

In reference to "consent," the question of whether or not the IPR owner "consented" to the first marketing of the product has assumed an almost overriding importance. As the Court noted in Hag II, "consent" is an essential criterion.[106] Prior to Hag II, the Court placed considerable emphasis on the issue of "consent", an example of which can be seen in two earlier cases."[107]

In **Musik-Vertreib Membram**, the German Performing Rights Society (GEMA) claimed damages from two parallel importers seeking to recover the difference between a license fee paid for records and music cassettes in Great Britain and the (higher) license fee customarily charged in Germany. GEMA was commissioned to represent copyright interests of recorders. The Court ruled that where the records had been put into circulation in a

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[105] This paper will only discuss the issue of "consent" as it applies to the doctrine of exhaustion.

[106] See especially, CNL-Sucral v. Hag (Hag II), supra n.91.

[107] See Musik-Vertrieb Membran v. GEMA, ECR 147 (European Court January 20, 1981) and Merck v. Stephar, ECR 2063 (European Court July 14, 1981).

Member State by the owner of the copyright or with her approval, GEMA could not be allowed to charge a "levy" (in essence assisting the owner in "protecting" their trademark, as well as copyright rights) on products imported. Otherwise, private companies could impose a financial burden on the importation of audio media due to their crossing of the border. This would, in effect, result in isolation of national markets which the EEC Treaty was designed to eliminate.[108]

In the case of **Merck v. Stephar**, a patentee, Merck (an American company), had by itself marketed an unpatented drug in Italy. Patents for pharmaceuticals were unavailable in Italy at the time. Stephar was importing the drug from Italy into the Netherlands, thus, before the Court, Merck sought to prevent the importation by invoking its Dutch patent. The Court considered the situation such that Merck's claim did not provide sufficient justification to allow Merck to assert its patent rights in the Netherlands in order to prevent the imports from Italy. Merck was therefore unable to rely on its Dutch patent to prevent parallel importation of the drug into the Netherlands. Merck, said the Court, had had the option not to market its product in Italy at all. In effect, the Court took the view that consent is essen-

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[108] Id. at 163.

tial in determining whether or not the rights had been exhausted. Where the owner of an IPR "chooses" to market her product in a Member State where protection does not exist, she must accept the consequences.[109]

In summary, in view of the definition of the doctrine of exhaustion and the development of the Court's use of "consent" as an overriding consideration, an IPR owner will often be unable to rely upon parallel intellectual property rights to avail herself of protection under Article 36's derogation to Article 30 and ultimately prevent parallel importation of goods between Member States within the EC. However, in certain circumstances, especially where goods sold are of differing quality under the same trademark, parallel importation may still be prevented.[110]

V. THE COMPARISON

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[109] This is difficult to reconcile with the aforementioned doctrine of exhaustion because as there was no patent protection afforded in Italy, there was no parallel right in the Netherlands to be protected. Note that a similar **Merck** situation does not necessarily prohibit the IPR owner from relying on parallel rights (if they exist) in other Member States to prevent such importation.

[110] See especially Colgate-Palmolive v. Markwell Finance, supra n.101.

Clearly under both the European and United States situations in regards to gray market goods (or parallel imports in the EC)[111] the system is monetarily driven. The most obvious method of controlling the importation of gray market goods then would be the adoption of a uniform pricing policy, whereby short of any "shortages" in goods in the country of import, there should be no reason for the importation of gray market goods.[112] In short, absent the necessary price differentials in various countries between the same goods in the exporting and importing countries, there will be no opportunity to make a profit. Unfortunately, this will not be a feasible alternative as pricing differentials usually are out of the control of the manufacturer.[113] For these reasons, we are held to the present state of enforcement - the use of intellectual property rights.

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[111] At this point, for simplification, the term "parallel imports" will be referred to as, and included in, the author's use of the term "gray market goods."

[112] It is suggested that under this scheme, gray market goods will be replaced by black market goods, which can then be dealt with via appropriate criminal prosecution.

[113] This pricing differential should be less apparent, especially where the European Community countries are concerned because of the fact that all of the major EC countries are members of the European Monetary System and, therefore, have almost a fixed exchange rate. This, however, remains to be seen.

As discussed, within the European Economic Community various methods of enforcement have been attempted. Articles 30-36 relate only to the free movement of goods. Inasmuch as some of the EC gray market goods problem arises from parallel imports from non-EC countries, the implementation of these articles have largely been ineffective. Also as noted, the EC objectives as a common market are to promote expansion, harmonious development, and closer relations between Member States, among others.[114] These protections seem somewhat constrained in that in order to obtain effective protection, the owner of the IPR must ensure that the goods and the related trademark are not "exhausted" under the prevailing view of exhaustion; that the goods sought to be excluded are of differing quality such that the difference will likely cause damage to the general public; and that the present "owner" of the mark was in no way previously affiliated with the original owner of the mark (additionally, protection is weak, at best, for goods that are imported from countries outside the EC.) Even so, the effect (diminished as it may seem) of these

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[114] In addition to Articles 30 - 36, Member States rely upon Articles 85 and 86 of the EC Treaty. These are similar to United States antitrust laws, however, EC competition policy differs somewhat. Specifically, Article 85, which prohibits restrictive trade, permits exemptions to arrangements that do not eliminate competition and which, more importantly, ultimately provide benefits to consumers.

rules on the free movement of goods tends to indicate that further expansion of protection is required. But for now, manufacturers will need be content with obtaining protection from the established means.[115]

By comparison, protection in the United States is also somewhat limited, if not purely from the established laws and case precedent, then from the lack of use by United States trademark owners of all avenues available. As indicated, largely, American trademark holders have relied upon the forces of Customs, as well as section 536 of the tariff Act and section 133.21 of the Customs regulations. Clearly, the protection afforded here impedes importation from countries outside the United States by those authorized to use the mark abroad. Furthermore, under section 42 of the Lanham Act, even though an

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[115] Earlier, some authors had proposed that there be a single Community Trade Mark system. See generally, David C. Wilkinson, The Community Trade Mark Regulation and Its Role in European Economic Integration, 80 TMR 107 (1990); Laurence J. Cohen and Adam N. Cooke, How Trademarks and Other Rights May Be Used To limit Parallel Imports in Europe, 81 TMR 371 (1991); James E. Rosini and Christopher C. Roche, Trademarks in Europe 1992 and Beyond, AIPLA Q.J., P. 213; Vol. 19; No. 3; (1991). The CTM registration system, it was proffered, would go a long way towards easing the impact of gray market goods. The CTM Regulation was finalized by Council Regulation (EC) No. 40/94, December 20, 1993. (The CTM Registration System and its impact is beyond the scope of this paper and will not be discussed further.)

importer is related to the company which owns the mark, parallel imports may be prevented of good with disparate qualities.

It seems then that protection of goods processed abroad can be maintained by both trademark owners within the European Community and the United States. It would also appear that the United States' position is strengthening (especially in regards to goods of disparate qualities) and the position of the EC is likewise gaining strength. An apparent difference here is that in order to obtain protection of goods that differ in quality, i the EC the trademark owner must no have given any consent to use to the proposed parallel importer. Be that as it may, protection afforded in the United States and within the European Community appear to parallel each other in both effectiveness and the direction in which the protection is moving.