

# Trademark Law, Economics and Grey-Market Policy

In the old days, it used to be said that the Twentieth Century Motor trademark was as good as the karat mark on gold. . . . [T]hey thought that this trademark was a magic stamp which did the trick by some sort of voodoo power . . . . Well, when our customers began to see that we never delivered an order on time and never put out a motor that didn't have something wrong with it—the magic stamp began to work the other way around: people wouldn't take a motor as a gift, if it was marked Twentieth Century.

—A. Rand<sup>1</sup>

## INTRODUCTION

The controversy surrounding the legality of grey-market imports has increased markedly in the last few years.<sup>2</sup> A grey market is created by the unauthorized importation of legitimately trademarked goods which enter the United States against the wishes of the domestic trademark owner. The classic case of grey-market importation occurs when a foreign manufacturer contracts with a domestic distributor to import goods according to mutually agreed upon terms. The U.S. dealer then registers the trademark owned by the foreign manufacturer in the United States. The grey market is formed when a third party buys the goods from retail or wholesale outlets in the foreign country, imports the goods and sells them to retailers in the United States in alleged violation of the authorized distributor's trademark rights.<sup>3</sup> The U.S. trademarkholder claims that the grey-market importer "free-rides" on the owner's investments in advertising and other goodwill-creating activities.

Consumers also have an interest in the grey market. Generally, more imports mean more competition and lower consumer prices. Critics of the

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1. A. RAND, *ATLAS SHRUGGED* 624 (1957).

2. Several significant grey-market cases were decided in 1985-86: *Olympus Corp. v. United States*, 792 F.2d 315 (2d Cir. 1986); *Coalition to Preserve the Integrity of Am. Trademarks (COPIAT) v. United States*, 790 F.2d 903 (D.C. Cir. 1986), *cert. granted* 107 S. Ct. 642 (1987) (hearing granted in three cases on appeal from 790 F.2d 903; *K-Mart Corp. v. Cartier, Inc.*; *47th Street Photo, Inc. v. COPIAT*; *United States v. COPIAT*. Consolidated argument limited to one hour); *Vivitar Corp. v. United States Customs*, 761 F.2d 1552 (Fed. Cir. 1985); *Weil Ceramics & Glass, Inc. v. Dash*, 618 F. Supp. 700 (D.N.J. 1985); *Selchow & Righter Co. v. Goldex Corp.*, 612 F. Supp. 19 (S.D. Fla. 1985).

3. Another grey-market scenario occurs when a domestic manufacturer opens a plant abroad in order to manufacture goods intended for sale abroad. A third party would be creating a grey market by buying the goods abroad, importing them into the United States and selling them in competition with the domestically manufactured goods of the same trademark. For other grey market fact patterns involving cross-licensing and multiple parties, see H. STEINER & D. VAGHETS, *TRANSNATIONAL LEGAL PROBLEMS* 1024 (2d ed. 1976).

grey market, however, claim that the imports are usually not backed by a warranty and are sometimes inferior in quality because the importer is not obligated to follow the manufacturer's requirements for shipping and storage.<sup>4</sup>

The complicating factors in this scenario include a statute that on its face seems to exclude all grey-market goods<sup>5</sup> and a Customs Service interpretation of the statute which allows grey-market goods into the United States in some situations.<sup>6</sup> This inconsistency has spawned a great deal of conflict in the federal courts. In two recent cases the Second and Federal Circuits ruled that the Customs' Regulations are a reasonable agency interpretation of the statute they implement and that grey-market goods may be imported.<sup>7</sup> The District of Columbia Circuit, however, recently held that the Customs' Regulations are invalid and that grey-market imports may not be imported into the United States.<sup>8</sup>

While recent court cases have been litigated, the volume of grey-market imports has increased dramatically.<sup>9</sup> Some estimates claim that a large percentage of all Sieko watches<sup>10</sup> and approximately fifteen to twenty-five percent of all photographic equipment sold in the United States originates from grey-market sources.<sup>11</sup> Additionally, unauthorized imports comprise a large percentage of all Mercedes-Benz sales in America.<sup>12</sup>

This Note analyzes the grey-market issue with an emphasis on trademark law principles and economic policy. Part I outlines the economic incentives underlying trademark law and their relevance to grey markets. Part II discusses the legislative and judicial inconsistency in the grey-market field. Part III analyzes recent decisions using the economic principles developed in Part I. Part IV summarizes proposals for reform and concludes that the most efficient solution to the problem is for the Customs Service to exclude all grey-market imports.

## I. TRADEMARK LAW, ECONOMIC INCENTIVES AND THE GREY MARKET

There are two ways in which an importer can realize a favorable rate of return by importing grey-goods. First, the importer, without making any

4. See *infra* notes 109-14 and accompanying text.

5. The Tariff Act of 1933 (19 U.S.C. § 1526 (1982)). For the pertinent portion of § 1526, see *infra* note 42.

6. 19 C.F.R. § 133.21 (1986). For the pertinent portion of § 133.21 see *infra* note 47.

7. See *Olympus*, 792 F.2d 315; *Vivitar*, 761 F.2d 1552.

8. See *COPIAT*, 790 F.2d 903.

9. Riley, "Gray Market" Fight Isn't Black and White, 8 NAT'L L. J. No. 7, Oct. 28, 1985, at 22, col. 1.

10. *Id.*

11. *Are Those Cheap Cameras for Real?*, CONSUMER REPORTS, May 1985, at 300.

12. D. Tarr, An Economic Analysis of Gray Market Imports 35, n.36 (Sept. 6, 1985) (unpublished paper). The list of grey-market imports is long: photographic equipment, portable radios, cassette players, watches, wines, batteries, perfumes and automobiles are some of the largest volume imports.

investment in the reputation of the goods, can free-ride on the existing domestic reputation of the goods.<sup>13</sup> Second, the importer can free-ride on the service offerings that the authorized importer (the trademark holder) makes to its customers.<sup>14</sup> Both of these situations involve trademark law.<sup>15</sup> An understanding of the economic basis of trademark law, then, is a prerequisite to any discussion of the grey market.

Trademarks protect both the consumer and the markholder. A trademark serves to: (1) identify and distinguish goods; (2) indicate the source of origin of the goods; (3) assure that all goods are of equal quality; (4) promote investments in quality and advertising by the markholder; and (5) represent goodwill.<sup>16</sup> Once a consumer buys a good and finds it to be satisfactory he can rely on the trademark to make another purchase at a later date. Through its operation in the marketplace the trademark reduces consumer search costs.

Once consumers are able to identify a trademarked good they may buy it again with the expectation that it will be of similar quality. The trademark represents an overall package of goods, reputation and service to the consumer. When trademarked goods are in use in the economy, the trademark advertises for the manufacturer. Consumers use trademarks to identify goods that they wish to purchase again. This tendency to make repeat purchases of satisfactory goods is the basis of the producer's goodwill.<sup>17</sup>

Trademarks help to promote economic efficiency by giving the manufacturer an incentive to produce quality goods, knowing that consumers will be able to identify and rely upon them. Trademark law promotes these

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13. Free-riding is most likely to occur when an organization provides a collective benefit to its members. In the grey-market situation, goodwill provides a collective benefit to those who sell the goods. Not all members of the group, however, make a contribution to the goodwill. For a discussion of free-rider problems, see P. AREEDA, *ANTITRUST ANALYSIS* ¶ 503 (3d ed. 1981); W. NICHOLSON, *MICROECONOMIC THEORY* 622-23 (2d ed. 1978).

14. Two other methods exist by which the grey-market importer can make a profit. The first occurs when the importer brings genuine but inferior goods into the country. The goods are genuinely trademarked goods but have become inferior in quality as a result of improper handling and storage. See *In the Matter of Certain Alkaline Batteries*, U.S.I.T.C. Invest. No. 337-TA-165, Nov. 1984 [hereinafter *Alkaline Batteries*]. The second method by which an importer can profit is to use favorable exchange rates to arbitrage the goods. This can happen whether or not the importer is relying upon the domestic reputation of the goods to increase their worth. For a more complete discussion of all four methods, see Knoll, *Gray-Market Imports: Causes, Consequences and Responses*, 18 *LAW & POL'Y INT'L BUS.* 145 (1986).

15. Trademark law is implicated in almost all grey-market cases. Copyright law, however, was recently at issue in the International Trade Commission's investigation, *In re Cabbage Patch Kids*, U.S.I.T.C. Invest. No. 337-TA-231, Sept. 1985, in which the petitioner argued that the birth certificates of the dolls were protected by copyright law. An unfair competition claim was brought under § 337 of the Tariff Act of 1930 (19 U.S.C. § 1337 (1982)) in *Alkaline Batteries*, *supra* note 14. Some proponents of the grey market claim that exclusion of the grey-goods can lead to price discrimination in violation of the antitrust laws. See *infra* note 49 and accompanying text.

16. R. CALLMANN, *UNFAIR COMPETITION, TRADEMARKS & MONOPOLIES* § 17.01-.04 (4th ed. 1983); J. MCCARTHY, *TRADEMARKS AND UNFAIR COMPETITION* 104 (2d ed. 1984).

17. J. MCCARTHY, *supra* note 16, at 74.

protections for the consumer and provides incentives for the manufacturer.<sup>18</sup> Producers and consumers alike are hurt, however, when trademark rights are violated. For example, if infringing goods are of lesser quality than authorized trademarked goods, the consumer will associate the infringing goods with the whole brand of goods and downgrade his estimation of the trademark. This downward revision hurts both the consumer and the manufacturer. The consumer can no longer rely on the trademark to tell him that the goods he is buying are of a certain quality, and the manufacturer's reputation is damaged through no fault of his own. Consequently, the traditional focal point of a trademark infringement action has been the element and degree of consumer confusion.<sup>19</sup> Infringement actions are most easily won when there is confusion regarding the *quality* of the goods.<sup>20</sup> A more complicated action arises when the alleged infringing goods are actually genuine goods, imported through an unauthorized chain of distribution—the grey-market scenario. The above stated principles of trademark law, however, indicate that infringement actions should also be permitted against grey-market goods.

While the actual quality of the grey-market goods is occasionally at issue<sup>21</sup> most cases focus on the damage done to the domestic goodwill the trademark owner and authorized dealer have developed.<sup>22</sup> This goodwill is developed by warranties, quality control procedures, service staff, inventory, available accessories, floor demonstrations, advertising and other consumer convenience offerings. Damage to goodwill is done in two ways. First, the grey-market importer can free-ride on the domestic goodwill developed by the trademark owner. These investments in goodwill are made in expectation that the trademark owner and retailer will receive a reward—more patronage by the consumers.<sup>23</sup> Part of this reward is stolen away from the trademark owner if consumers purchase grey-market goods. This free-rider problem is inherent in all grey markets. Second, if the grey-market importer does not provide the same services and conveniences that the trademark owner provides there is a likelihood that the goodwill associated with the trademark will be damaged. This damage will hurt the trademark owner because con-

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18. R. CALLMANN, *supra* note 16, at § 17.04.

19. J. MCCARTHY, *supra* note 16, at 54.

20. When the goods are not what the label claims they are the courts invariably find a trademark infringement. In *Coors v. Genderson & Sons*, 486 F. Supp. 131, 136 (D. Colo. 1980), the court likened the beer defendant was selling across the United States to counterfeit goods. The quality of the beer had so diminished that the beer was not what the label claimed it to be.

21. In *Alkaline Batteries*, *supra* note 14, at 3, proof was offered that improper handling and storage had damaged the quality of the batteries.

22. See *infra* text accompanying notes 98-114.

23. J. MCCARTHY, *supra* note 16, at 74. McCarthy argues that goodwill is a form of "buyer momentum" that will result in more patronage by consumers.

sumers will not value the trademark as highly as they otherwise might.

The argument for using trademark law to attack grey-market goods is strongest where the authorized seller provides service in the United States. The rationale behind excluding grey-market goods in this case is to protect the authorized seller's investment in such service. This investment—made to increase the value of the trademark in the United States—provides an opportunity for free-riding by grey-market operators. Investments such as the ones made by the trademark owner and his authorized sellers have traditionally been protected in other fields of the law.<sup>24</sup>

It is harder to justify exclusion of grey-market goods when no investment has been made in domestic goodwill. In such cases no domestic goodwill is associated with the trademark. Hypothetically, this might occur where goods have an international reputation that is not distinct from their reputation in individual countries. The goods, however, would have to be of the type such that no service after the sale or warranty coverage was needed. Exclusion would not be justified in such cases because no investment on which the grey-market operator could free-ride exists. This idea is reflected in the exhaustion doctrine of trademark law which asserts that once a trademarked good is placed into the stream of commerce anywhere in the world, the trademark owner can no longer sustain an infringement action.<sup>25</sup> The exhaustion doctrine, however, usually does not apply when a distinct goodwill is associated with the trademarked good.<sup>26</sup>

This distinction between situations in which free-riding can occur and when it cannot is important. Since the market will operate more efficiently when free-riding is prevented, courts that address the grey-market question should recognize this distinction.<sup>27</sup>

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24. The Supreme Court in *International News Service (I.N.S.) v. Associated Press*, 248 U.S. 215, 236 (1918) reasoned that in order to encourage investments an investor should be able to recoup his expected return. In *I.N.S.* the court ruled that the defendant could not take the plaintiff's news reports and use them for his own publications. The Court recognized that the plaintiff had to be protected in order to encourage him to gather the news in the first place.

25. *Derenberg, Territorial Scope and Situs of Trademarks and Goodwill*, 47 VA. L. REV. 733 (1961).

26. R. CALLMANN, *supra* note 16, at § 17.01-.04; J. MCCARTHY, *supra* note 16, at 69-87. See also *Weil Ceramics & Glass, Inc. v. Dash*, 618 F. Supp. 700, 713 (D.N.J. 1985).

27. It is important to note that grey-market importation can occur whenever the investment in goodwill (per unit of sales) in the United States exceeds such investment in another country. It makes no difference whether the investment in goodwill is made by the authorized seller or the manufacturer himself. If less is invested in goodwill in other countries than in the United States, prices will be lower in those countries than in the United States. This will create an opportunity for grey-market shipments from lower price areas to those in which higher prices prevail. Grey-market importers will be free-riding on the greater investment that has been made in the United States.

## II. JUDICIAL AND LEGISLATIVE BACKGROUND

The first case to address the grey-market question was *Apollinaris Co. v. Scherer*,<sup>28</sup> in which the court refused to exclude the genuine goods imported by an unauthorized importer into the United States. This holding was based on the universality principle of trademark law, in which a trademark represents the good on a worldwide basis.<sup>29</sup> This interpretation of trademark law has since been discredited and replaced with the territoriality principle.<sup>30</sup> The territoriality principle was endorsed by the United States Supreme Court in the 1920's and allows the trademark holder a separate set of rights and protections in each individual country in which the trademark is registered.<sup>31</sup> The move from the universality principle to the territoriality principle had significant implications for the grey-market debate.

These implications were realized by the Supreme Court in 1923 when it decided the case of *A. Bourjois & Co. v. Katzel*.<sup>32</sup> The *Katzel* Court held that a domestic owner of a trademark used on foreign manufactured goods had an action against an unauthorized importer of the same goods. The plaintiff had purchased the United States operations of a French face powder manufacturer, including the rights to two United States trademarks, "Java" and "Bourjois."<sup>33</sup> The consumer goodwill already associated with the goods in the United States was not diminished as a result of the transaction. The plaintiff imported the powder from the French manufacturer and sold it, using packaging that was substantially similar to that used by its predecessor. The boxes had a statement of domestic trademark registration disclosing that the product was made in France and packaged in America.<sup>34</sup> The unauthorized importer bought the powder from the manufacturer in France, and then imported and sold it in the United States in boxes bearing the "Java" trademark and resembling the plaintiff's boxes.<sup>35</sup>

The court of appeals in *Katzel* ruled there could be no trademark violation because the importation of the genuine goods did not confuse consumers.<sup>36</sup> In reversing, the Supreme Court held that the unauthorized importation and sale of the goods by defendant violated sections 17 and 19 of the Trademark Act of 1920, the predecessor of the Lanham Act.<sup>37</sup> The Court correctly

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28. 27 F. 18 (E.C.S.D.N.Y. 1886).

29. J. MCCARTHY, *supra* note 16, at §§ 26.12, 26.17 (describing the move from the universality principle to the territoriality principle).

30. *Id.* See also *A. Bourjois & Co., Inc. v. Katzel*, 260 U.S. 689 (1923).

31. J. MCCARTHY, *supra* note 16, at 54.

32. 260 U.S. 689.

33. *Id.* at 690.

34. *Id.* at 691.

35. *Id.*

36. *A. Bourjois & Co. v. Katzel*, 275 F. 539 (2d Cir. 1921).

37. *Katzel*, 260 U.S. at 690.

recognized that the domestic goodwill associated with the trademark was entitled to trademark protection. The court of appeals had erroneously assumed that confusion as to source was the only relevant issue.<sup>38</sup> The Supreme Court found that the box markings were similar and as a result, consumers identified the good with the foreign manufacturer and were not confused. The Supreme Court protected the more important goal of trademark law by recognizing the investments that the trademark holder had made in promoting the face powder in the United States. In its view, the goodwill was distinct from the goodwill associated with the goods' manufacturer in France.<sup>39</sup> The *Katzel* decision, then, endorsed the territoriality principle of trademark law by allowing the trademark owner a separate set of rights in the new country of registration.<sup>40</sup>

While *Katzel* was pending in the Supreme Court, Congress enacted section 526 of the Tariff Act of 1922 to remedy what it saw as a gap in trademark protection for a domestic owner of a trademark.<sup>41</sup> Section 526 excludes any goods bearing a registered trademark owned by a United States corporation or citizen unless the importer has permission from the trademark owner.<sup>42</sup> Original interpretations of section 526 barred all grey-market imports.<sup>43</sup> Subsequent interpretations of that section, however, have narrowed its application to the specific facts of the *Katzel* case.<sup>44</sup> The *Katzel* fact pattern allowed the trademark owner protection when he had bought the domestic portion of the international enterprise.

Recent interpretations of section 526 do not provide protection to the trademark owner if he is affiliated with the foreign manufacturer.<sup>45</sup> These

38. *Katzel*, 275 F. at 543.

39. *Katzel*, 260 U.S. at 692.

40. *Id.* *Osawa v. B & H Photo*, 589 F. Supp. 1163, 1173 (S.D.N.Y. 1984) is representative of the prevailing interpretation of Justice Holmes' opinion in *Katzel* that endorses the territoriality principle.

41. The Tariff Act of 1930, ch. 497, 46 Stat. 741, § 526 (codified as amended in 19 U.S.C. § 1526 (1982)).

42. Section 526 provides in part:

[I]t shall be unlawful to import into the United States any merchandise of foreign manufacture if such merchandise, or the label, sign, print, package, wrapper, or receptacle, bears a trademark owned by a citizen of, or by a corporation or association created or organized within, the United States, and registered in the Patent and Trademark Office . . . .

19 U.S.C. § 1526(a). Section 526 also does not apply when the goods are intended for personal use and not for resale. 19 C.F.R. § 133.21(c)(7) (1986).

43. *See Vivitar Corp. v. United States Customs*, 761 F.2d 1552 (Fed. Cir. 1985). The *Vivitar* court analyzed § 526 and concluded that no restrictions were placed on the application of the statute up until 1936 when the "same person exception" was formulated. This exception prohibited the application when the U.S. trademark holder and the foreign manufacturer were the same person. *Id.* at 1566.

44. After 1953 the related company exception was formed. *Id.*

45. *Vivitar* held that the Customs' Regulations which restrict the application of section 526 are a reasonable administrative interpretation of the statute. *Id.* at 1570.

interpretations have been codified in section 133.21 of the Customs' Regulations.<sup>46</sup> The Regulations do not allow related companies to use section 526 nor do they allow the markholder to use section 526 if he is the same person or corporation that owns the foreign trademark.<sup>47</sup> The Supreme Court, however, has not yet addressed this narrow interpretation of section 526.<sup>48</sup> Additionally, the limited scope of section 526 as defined in the Customs' Regulations does not protect the economic incentives that trademark law seeks to encourage. The concerns that gave rise to the restrictive interpretation of section 526 have never been seriously realized. The concern apparently was that if the markholder and manufacturer were a single international enterprise, they would likely manipulate section 526 in order to exclude competition and engage in price discrimination in different international markets. While there is limited support for the price discrimination argument,<sup>49</sup> cases and commentators alike have not found the argument compelling.<sup>50</sup> A monopoly is not created when the output of one manufacturer in a competitive market is restricted.<sup>51</sup> Assuming *arguendo* that price discrimination is a valid concern, the proper tool to fight this practice would be the antitrust laws, not the trademark laws. In attempting to fight a largely unrealized threat of price discrimination, the narrow interpretation of section 526 allows grey-market importers to misappropriate consumer goodwill that has been developed by the domestic trademark holder.

The antitrust issues relating to the scope of section 526 were litigated in *United States v. Guerlain*.<sup>52</sup> In *Guerlain* the court ruled that *Katzel* was distinguishable and the protection would not be allowed when there is a

46. 19 C.F.R. § 133.21 (1986).

47. The Customs' Regulations outline the protection of § 526 and state that the protection is not available if:

(1) Both the foreign and the U.S. trademark or trade name are owned by the same person or business entity;

(2) The foreign and domestic trademark or trade name owners are parent and subsidiary companies or are otherwise subject to common ownership or control . . . ;

(3) The articles of foreign manufacture bear a recorded trademark or trade name applied under authorization of the U.S. owner.

19 C.F.R. § 133.21(c)(1)(2)(3).

48. The scope of the regulations in § 133.21 have been subject to some criticism. See *Weil Ceramics & Glass, Inc. v. Dash*, 618 F. Supp. 700, 717 (D.N.J. 1985). The Supreme Court will likely address the question in 1987 in *Coalition to Preserve the Integrity of Am. Trademarks v. United States*, 790 F.2d 903 (D.C. Cir. 1986), *cert. granted* 107 S. Ct. 642 (1987).

49. See C. Collier, *Competition Policy and Parallel Imports* (Oct. 23, 1985) (unpublished paper presented before the Second Annual Judicial Conference of the United States Court of International Trade). See also *Dam, Trademarks, Price Discrimination and the Bureau of Customs*, 7 J.L. Econ. 45, 48 (1964).

50. The court in *Osawa* is representative of the prevailing view that the antitrust claims with regard to grey-market goods are weak. 589 F. Supp. at 1176.

51. See P. ARBEDA, *supra* note 13, at ¶¶ 262, 512.

52. 155 F. Supp. 77 (S.D.N.Y. 1957).



connection between the foreign manufacturer and the domestic dealer. The court ruled that the domestic trademark holder had committed an antitrust violation by using section 526 to exclude potential competition from grey-market importers.<sup>53</sup> No mention of Customs' Regulations was made in the case. The government subsequently dropped *Guerlain* on appeal, believing that Congress should resolve the apparent conflict between section 2 of the Sherman Act and section 526 of the Tariff Act.<sup>54</sup> Congress, however, never specifically addressed the issue.

Several recent cases have concluded that the *Guerlain* court's concern over an antitrust violation is untenable.<sup>55</sup> Recent developments in antitrust law support this conclusion. Specifically, since exclusive territory restrictions are now analyzed under the rule of reason rather than the per se rule, it is less likely that any antitrust violation will be found when grey-market goods are excluded from importation.<sup>56</sup>

In addition to section 526, Congress has passed two trademark infringement statutes which have been the subject of much grey-market litigation. Section 42 of the Lanham Act of 1905<sup>57</sup> empowers the Bureau of Customs to prevent importation of any goods which "copy or simulate a trademark registered [in the United States]."<sup>58</sup> Another provision of the Lanham Act, section 32,<sup>59</sup> provides for a private civil action against anyone who sells or imports goods that simulate a trademark if such use of the trademark "is likely to cause confusion, or to cause mistake, or to deceive."<sup>60</sup> These latter

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53. *Id.* at 98. The government in *Guerlain* alleged that defendants had attempted to monopolize the importation and sale of trademarked perfumes through the use of § 526.

54. See the discussion regarding the *Guerlain* decision in *Vivitar*, 761 F.2d at 1566-67.

55. See *Bell & Howell: Mamiya Co. v. Masel*, 548 F. Supp. 1063 (E.D.N.Y. 1982), *preliminary injunction vacated* 719 F.2d 42 (2d Cir. 1983); *Vivitar*, 761 F.2d at 1564; *Weil*, 618 F. Supp. at 714. Moreover, it is doubtful that damage to consumer welfare could occur when there are *intradbrand* restrictions. See *Liebeler, Intradbrand "Cartels" Under GTE Sylvania*, 30 UCLA L. REV. 1, 5-6 (1982).

56. The Supreme Court in *Continental T.V. v. GTE Sylvania*, 433 U.S. 36 (1977) recognized the efficiency-creating potential in exclusive territorial restraints. The exclusion of grey-market goods results in an arrangement similar in nature to an exclusive territorial agreement. Under *GTE Sylvania* the plaintiff must prove that there are anticompetitive effects before a violation will be found.

57. Lanham Act of 1905, ch. 540, 33 Stat. 730, § 42 (codified as amended in 15 U.S.C. § 1124 (1982)).

58. Section 42 of the Lanham Act reads in part: "no article of imported merchandise which shall copy or simulate the name of [any merchandise of] any domestic manufacture, or manufacturer, . . . or which shall copy or simulate a trademark registered in accordance with the provisions of this chapter . . . shall be admitted to entry at any customhouse of the United States . . ." 15 U.S.C. § 1124. "Copy or simulate" has been held to be applicable to grey-market goods which are actually not copies or simulations but are the genuine goods. See *Bourjois*, 263 U.S. 675.

59. Lanham Act of 1905, ch. 540, 33 Stat. 728, § 32 (codified as amended in 15 U.S.C. § 1114 (1963)).

60. Section 32 of the Lanham Act reads in part:

(1) Any person who shall, without the consent of the registrant—

two statutes have been applied in several grey-market cases, and plaintiffs have met with varied success in combating grey-market goods that infringe the registered domestic trademark.<sup>61</sup> Private rights of action under the trademark laws are generally not as effective as actions which empower Customs to exclude the goods. Often times the trademark owner cannot identify the grey-market importer and once he does, jurisdiction may be impossible. Hence, he may be forced to entertain several small suits against retailers who sell grey-market goods.<sup>62</sup>

### III. JUDICIAL INCONSISTENCY IN RECENT GREY-MARKET LITIGATION

Three principles emerge from the discussion of trademark law, *Bourjois v. Katzel*, and *United States v. Guerlain*. First, the protection of domestic goodwill created by a trademark owner will impart the proper incentives to develop and maintain quality goods. Second, the *Katzel* decision and the express language of section 526 suggest that grey-market imports be prohibited. Third, *Guerlain* and the Customs' Regulations provide for exceptions to the general rule against grey-market imports. The inconsistency of these principles and the failure of some courts to focus on the economic issues underlying trademark law have led to a conflict among recent grey-market cases.<sup>63</sup> One line of cases ignores the domestic goodwill associated with the trademark and interprets consumer confusion to mean confusion as to the source or origin of the goods.<sup>64</sup> These cases find no confusion because both grey and authorized goods come from the foreign manufacturer.<sup>65</sup> A second line of cases has barred importation of grey-market imports or awarded damages on trademark infringement grounds. These cases rely on a broad reading of *Katzel* and on traditional trademark protection goals. Specifically, they protect the distinct goodwill that the trademark owner has developed.<sup>66</sup> A misunderstanding of the goals of trademark law along with the continued misperception of *Katzel* and section 526 have helped create these inconsistent outcomes. The following analysis of these recent cases will suggest that

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(a) use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive:

shall be liable in a civil action by the registrant.

15 U.S.C. § 1114 (1)(a).

61. See *infra* notes 67-126 and accompanying text.

62. See *infra* note 165 and accompanying text; see also *Alkaline Batteries*, *supra* note 14, at 22. Sanctions under the Federal Rules of Civil Procedure were threatened if the grey-market retailer did not divulge his source.

63. See *infra* notes 67-126 and accompanying text.

64. See *infra* text at notes 67-90.

65. See *infra* notes 67-90 and accompanying text.

66. See *infra* notes 91-126 and accompanying text.

proper interpretations of the law regarding grey-market imports will result in the exclusion of grey-market goods or successful trademark infringement suits once the goods have arrived.

### A. *Trademark Infringement Actions*

Several recent cases in federal court have denied relief for a trademark owner filing suit alleging trademark infringement against a grey-market importer. In *Monte Carlo Shirt v. Daewoo International*,<sup>67</sup> the Ninth Circuit held that an action under common law trademark principles was insufficient because the plaintiff could not demonstrate that there was any confusion as to the source of origin of the goods.<sup>68</sup> The plaintiff contracted with a foreign manufacturer to buy, import and sell foreign made shirts. The plaintiff owned the common law trademark rights in the United States.<sup>69</sup> Monte Carlo rightfully rejected the shirts on lateness grounds under the contract.<sup>70</sup> Subsequently, the manufacturer sold the shirts to its United States subsidiary who sold them without the permission of the markholder. The plaintiff sued both the manufacturer and the grey-market importer for common law trademark infringement.<sup>71</sup>

The court reasoned that because the shirts had been made and delivered in the appropriate way there were no quality problems.<sup>72</sup> If the shirts had been of poor quality and had been resold by the grey-market importer then the trademark infringement action would likely have succeeded.<sup>73</sup> The court continued its trademark analysis and concluded that because the labels indicated where the shirts were manufactured there could not be any confusion as to the source.<sup>74</sup> The court's argument was logical up to this point. The court went on to say, however, that the consumer gets exactly what he paid for.<sup>75</sup> In this case, a warranty policy regarding the shirt is the most likely consumer convenience element that is missing.<sup>76</sup> The consumer is likely to be deceived by the grey-market purchase because when he relies on the trademark he expects the purchase price to include a package of goods and

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67. 707 F.2d 1054 (9th Cir. 1983).

68. *Id.* at 1058.

69. *Id.*

70. *Id.* at 1057.

71. *Id.*

72. *Id.* at 1056.

73. See *supra* note 20 and accompanying text regarding the discussion of the quality of the goods.

74. *Monte Carlo*, 707 F.2d at 1058.

75. *Id.*

76. The court in *Monte Carlo* did not even address the warranty question or the possibility that the defendant did not offer a warranty with the shirt.

services.<sup>77</sup> If the warranty is lacking, something the grey-market importer is not likely to disclose, the consumer can be misled. By ignoring the goodwill protection function of trademark law, the *Monte Carlo* court subjected consumers to possible confusion regarding the goods they purchased.

In addition, the trademark owner is hurt when a court does not protect the goodwill function of trademark law. When the grey-market importer does not provide the same services that the trademark owner and authorized dealers do, damage to the reputation of the trademarked goods can occur. This damage can result in decreased sales and lower prices for the trademarked item. Moreover, a grey-market importer realizes a benefit when he free-rides on the reputation (goodwill) of the trademarked goods. The trademark owner's investments in advertising, service, inventory, and warranty programs are granting a benefit to the grey-market importer who has not made an investment in promoting goodwill. The trademark owner, then, will not be encouraged to develop quality goods if he knows the grey-market importer can free-ride off of his investments.<sup>78</sup>

Trademarks provide an incentive for producers to invest in and promote goodwill. The markholder has invested in the product by registering the trademark, along with making expenditures in advertising, warranting, quality control, testing, storage and servicing the product. If the consumer is not satisfied with the product and its services, the investment is lost. The trademark owner makes this investment because he has a property right in the trademark. The property right should allow the holder to invest and realize a return on the investment. The grey-market importer, however, will not make an investment to promote goodwill because he has no property right in the trademarked good. A portion of the return on any investment that the grey-market importer makes will be diverted to the trademark owner. The grey-market importer, then, will misappropriate the trademark owner's goodwill. When the reputation of the trademarked goods suffers, the trademark holder is also hurt because the consumer is often unable to or unwilling to distinguish between the trademark owner and the grey-market importer. As a result, any damage to the reputation of the goods hurts the trademark owner.<sup>79</sup>

A similar factual situation was before the court in *El Greco Leather Products v. Shoe World*.<sup>80</sup> The court ruled that trademarked goods rejected by the United States trademark owner because of lateness under a contract

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77. In the case of a shirt sale, the package of goods and services is not as great as it would be with a more complicated purchase. For example, the *Osawa* court devotes a discussion to the fact that when a consumer buys a camera he expects that the sales staff will be knowledgeable in helping him pick out the camera he needs. *Osawa v. B & H Photo*, 589 F. Supp. 1163, 1166 (S.D.N.Y. 1984).

78. See *supra* note 16 and accompanying text.

79. See *supra* notes 16-19 and accompanying text.

80. 599 F. Supp. 1380 (E.D.N.Y. 1984).

could be resold without trademark violation.<sup>81</sup> The plaintiff had contracted with a manufacturer in Brazil to make and deliver shoes. When the shoes were delivered after the date specified in the contract, the plaintiff rejected the goods and the manufacturer resold them to the grey-market importer.<sup>82</sup> The court found that the rejection was due to lateness only and that any defects in the quality of the shoes were insignificant.<sup>83</sup> The court proceeded to reject the section 1114 infringement claim because the trademark owner had already impliedly vouched for the quality of the goods.<sup>84</sup> Similar to the *Monte Carlo* court, the *El Greco* court erred by viewing trademark goals too narrowly. The court neglected the goodwill issue. As a result, economic incentives to develop a quality reputation to back up a trademark were reduced and the free-rider problem was perpetuated.

The *El Greco* case is representative of many cases which consider disclosure of the origin of the goods as the primary goal of trademarks.<sup>85</sup> These cases properly consider the quality of the grey-market goods and will most likely find a trademark infringement if the grey-market goods are inferior in quality to the authorized goods.<sup>86</sup> To sever these goals of trademark law from the goodwill protection function, however, is to defeat the most important purpose of trademark law.<sup>87</sup> The consumers are concerned with the quality of the goods and the services and policies that accompany the goods. These concerns are not protected when courts recognize only the source of origin function.<sup>88</sup> Knowing that the goods are of Japanese origin serves little purpose when all warranty claims, repair service and other functions will be handled in the United States. Similarly, the trademark owner is concerned about damage to the goodwill associated with the product and free-riding by the grey-market importer. Again, courts that make certain that the trademarked good is where it purports to be from do not protect the trademark owner from these problems.<sup>89</sup> Cases that do not consider and protect the domestic

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81. *Id.* at 1401.

82. *Id.* at 1387.

83. *Id.* at 1390.

84. *Id.* Section 1114 allows the trademark owner to bring a civil action against any person who sells imitations of the trademarked goods. 15 U.S.C. § 1114 (1982).

85. See, e.g., *Monte Carlo*, 707 F.2d 1054; *DEP Corp. v. Interstate Cigar*, 622 F.2d 621 (2d Cir. 1980); *A. Bourjois & Co. v. Katzel*, 275 F. 539 (2d Cir. 1921).

86. However, in *Alkaline Batteries*, *supra* note 14, at 30 the International Trade Commission ruled that the inferiority of the grey-market batteries was not necessary to sustain the trademark infringement claim.

87. Recent decisions, however, have begun to interpret the source of origin function so that protection is given to the source that has any control over the quality of the goods. In most cases, this will be the domestic trademark holder or the authorized dealer. See the district court opinion in *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 548 F. Supp. 1063, 1069 (E.D.N.Y. 1982), *preliminary injunction vacated*, 719 F.2d 42 (2d Cir. 1983).

88. J. McCARTHY, *supra* note 16, at 56.

89. See *supra* note 16 and accompanying text.

goodwill developed by the trademark holder are ignoring the basic purpose of trademarks.<sup>90</sup>

Despite the late delivery cases,<sup>91</sup> other domestic trademark owners have been successful in bringing trademark infringement actions against grey-market importers. The trademark battle has been particularly fierce in the field of imported cameras and other electronic equipment.<sup>92</sup> In 1982, Bell & Howell Corporation filed suit to prevent a grey-market importer from selling their authorized line of Mamiya cameras imported from Japan.<sup>93</sup> The district court granted a preliminary injunction in finding that Masel Corporation, the grey-market importer, had violated both sections 32 and 42 of the Lanham Act<sup>94</sup> by importing the cameras and selling them under the Mamiya trademark.<sup>95</sup> The court criticized *Guerlain* for ignoring the distinct domestic goodwill that the trademark owner had developed<sup>96</sup> and rejected the claim that protection could not be given to Bell & Howell because they were partly owned by Mamiya. The court reasoned that the origin function of trademark law was worth protecting but interpreted the function to mean protection for the party responsible for the quality of the goods.<sup>97</sup>

The district court's opinion in *Bell & Howell* is a thoughtful insight into the way trademark protection should be applied to grey-market goods cases. Rather than blindly accepting the *Guerlain* court's decision to exclude related companies from protection, the court found that there was a distinct goodwill despite the relation between the two companies.<sup>98</sup> A correct interpretation of trademark law resulted in a finding of infringement. The court, then, balanced the potential harms and found the harm to the domestic goodwill more likely to be damaging than any potential price discrimination that might occur as a result of the exclusion of the grey-market goods.<sup>99</sup>

*Bell & Howell* rests on the finding of likelihood of confusion by consumers. The court found that the grey-market importer did not offer a warranty.<sup>100</sup> The service staff, inventory and repair service of the authorized dealer were

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90. *Id.*

91. Both *El Greco* and *Monte Carlo* involved the resale of genuine goods that were rejected by the trademark holder because of lateness under the delivery contract.

92. *Vivitar Corp. v. United States*, 761 F.2d 1552 (Fed. Cir. 1985), *Bell & Howell*, 548 F. Supp. 1063 and *Olympus v. United States*, 792 F.2d 315 (2d Cir. 1986) all deal with photo equipment.

93. *Bell & Howell*, 548 F. Supp. at 1065.

94. The court found that both 15 U.S.C. § 1114 and 15 U.S.C. § 1124, sections 32 and 42 of the Lanham Act, respectively, had been violated. *Bell & Howell*, 548 F. Supp. at 1066, 1071.

95. *Id.* at 1065.

96. *Id.* at 1076.

97. *Id.* at 1069.

98. *Id.* at 1070.

99. *Id.* at 1077. The antitrust rationale in *Guerlain* has been assailed by other courts. See *supra* note 50 and accompanying text.

100. *Bell & Howell*, 548 F. Supp. at 1068.

also superior to that of the grey-market importer.<sup>101</sup> These inconsistent offerings between authorized and unauthorized dealers resulted in consumer confusion regarding the trademarked goods. The court of appeals reversed *Bell & Howell*<sup>102</sup> because there was a lack of evidence that the grey-market goods were actually inferior to the authorized imports.<sup>103</sup> The court of appeals held that in order to sustain the action, Bell & Howell had to prove that a significant number of consumers would likely be misled.<sup>104</sup>

In a subsequent action, however, Bell & Howell's argument regarding the damage done to their goodwill was vindicated. Bell & Howell's successor in interest, Osawa Corporation, sued another grey-market importer and won.<sup>105</sup> The *Osawa* court had much the same views as Judge Leval in *Bell & Howell*. Osawa offered extensive proof of the goodwill they had developed.<sup>106</sup> The plaintiff only granted dealerships to those willing to provide the necessary goodwill-enhancing services.<sup>107</sup> The warranty policy caused the greatest problem for the plaintiff because many consumers came to the authorized dealer with cameras that were purchased from the grey-market importer. Fearing damage to their reputation, Osawa repaired the grey-market cameras without charge even though they were not required to do so.<sup>108</sup> Osawa was, of course, damaged by giving the repairs because they had not realized any return on the camera because it was bought for a lower price from the grey-market importer. The incentive to develop high quality goods and warrant them is reduced if Osawa is forced to perform repairs on grey-market goods in order to protect its reputation. When warranty repair service is paid for by the trademark owner, then the grey-market importer has even less of an incentive to maintain quality standards.

When a trademark owner excludes grey-market goods from the U.S., the effect is similar to that obtained by an exclusive territorial restriction. The restriction has economic efficiency creating potential because the free-rider problem can be eliminated.<sup>109</sup> While Osawa and the authorized Mamiya dealers maintained showrooms, an extensive inventory of parts and accessories, qualified service and repair staff and provided an extensive warranty, the grey-market importer did none of this.<sup>110</sup> The grey-market importer ran

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101. *Id.*

102. *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 719 F.2d 42 (2d Cir. 1983).

103. *Id.* at 46.

104. *Id.*

105. *Osawa v. B & H Photo*, 589 F. Supp. 1163.

106. *Id.* at 1166.

107. *Id.* These goodwill services include training for sales and service personnel, inventory, demonstrations and advertising. Moreover, the trademark owner spends a considerable amount of time inspecting the merchandise, and the dealer gives free warranty repairs.

108. *Id.* at 1166.

109. *See supra* note 56.

110. The court in *Osawa* recognized that:

a mail and telephone order business from which the consumer, after searching the market and making his choice based on the investments made by the authorized dealer, ordered the camera for a lower price.<sup>111</sup> The grey-market importer free-rides on all the investments that the trademark owner and dealer have made in order to promote the goods.

Goodwill is especially important in the electronic field, such as with the medium format cameras at issue in *Osawa*.<sup>112</sup> The complicated nature of the equipment and the need for advice and training by qualified personnel require that a substantial investment be made by the markholder and authorized dealer.<sup>113</sup> When the grey-market importer provides poor sales assistance and repair service the trademark owner is also hurt. Testimony to this damage is the fact that in the two years leading up to the *Osawa* litigation, over forty percent of authorized Mamiya dealers dropped the brand.<sup>114</sup>

In *Weil Ceramics & Glass, Inc. v. Dash*<sup>115</sup> the district court held that trademark protection should extend to the domestic markholder's reputation.<sup>116</sup> The foreign manufacturer of "Lladro" ceramic and porcelain products designated Weil as the exclusive distributor in the United States. Weil registered the "Lladro" trademark in the United States in 1966. In 1982 the defendant began to import and sell the "Lladro" product line from Spain without the permission of Weil. Weil filed suit in the district court in an attempt to enjoin the defendant from importing any more grey-market goods under section 526 and sections 32 and 42 of the Lanham Act.<sup>117</sup>

The court analyzed the development of section 32<sup>118</sup> and concluded that the trademark owners' reputation with respect to the goods was the element

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Defendants now state that they will offer their own warranty service on their grey Mamiya merchandise. Apart from the fact that this is a newly contrived litigation strategy designed to deal with a glaring weakness in defendant's position, it is also an unsatisfactory resolution that . . . risks to increase, rather than solve, the problems of trademark confusion.

589 F. Supp. at 1168. The court went on to explain that the confusion problem is not alleviated when the defendant offers a warranty, "[f]or the warranty is of value to the goodwill of the mark only if offered by one who has the incentive to uphold the reputation of the mark." *Id.* at 1169. Because the defendant has no property right in the trademark he does not have the requisite incentive.

111. *Id.* at 1166. The defendant also sells grey-market cameras over the counter. A strictly mail order business was at issue in *Selchow & Righter v. Goldex*, 612 F. Supp. 19 (S.D. Fla. 1985) when the defendant was selling grey-market Trivial Pursuit games through a mail order business.

112. The *Osawa* court recognized the likelihood of a "continuing relationship between dealer and customer involving advice, service, and the future purchase of specialized peripheral equipment expanding the capabilities of the camera." *Osawa*, 589 F. Supp. at 1166. Medium format cameras are complex cameras used by professional photographers and high level hobbyists.

113. *Id.*

114. *Id.* at 1168.

115. 618 F. Supp. 700 (D.N.J. 1985).

116. *Id.*

117. *Id.* at 703. See also *infra* notes 155-60 and accompanying text.

118. *Weil*, 618 F. Supp. at 704.



most worthy of protection.<sup>119</sup> In support of the contention that the statute was designed to protect the domestic goodwill, the court pointed out that a 1962 amendment to section 32 eliminated the reference to confusion as to source of origin. The revision changed the statute so that "confusion of any kind" could be grounds for a trademark infringement.<sup>120</sup> The court interpreted this confusion to mean confusion "as to the identity of the company standing behind and insuring the quality of the trademarked goods."<sup>121</sup> When there is confusion as to who is insuring the goods, the markholder's goodwill is likely to be injured. The *Weil* court ruled that the domestic markholder had developed a distinct goodwill in the United States as a result of the warranty, providing an English language instruction booklet, engaging in extensive advertising and establishing a nationwide dealer network.<sup>122</sup> Because a separate and distinct goodwill was developed in the United States by the trademark owner, the exhaustion doctrine was inapplicable.<sup>123</sup> The plaintiff proved that because of his efforts the "Lladro" product line was now well known in America whereas it was unknown before 1966.<sup>124</sup> Like the trademark owner in *Osawa*, Weil was also placed in the unenviable position of having to warrant products imported and sold by the grey-market importer or deny warranty protection and risk damage to its goodwill. Confusion arises because the consumer does not know who is backing the goods at the point of sale.<sup>125</sup> The court, however, solved this problem and the free-rider problems by holding that the defendant was infringing upon the plaintiff's trademark.

*Osawa* and *Weil* have properly recognized the importance of protecting the domestic goodwill developed by the trademark owner and his authorized dealers. This protection is warranted on policy grounds and as a reasonable interpretation of the Supreme Court's decision in *Katzel*.<sup>126</sup>

### B. Section 526 Cases and the Related Parties Exception Under 19 C.F.R. § 133.21

The recent cases that construe section 526 and the Customs' Regulations are not in agreement. Some courts hold that the Customs' Regulations are

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119. *Id.* at 706.

120. The *Weil* court stated: "Congress amended § 32 in 1962 deleting the source of origin requirement 'thereby evincing a clear purpose to outlaw the use of trademarks which are likely to cause confusion, mistake or deception of any kind, not merely of purchasers nor simply as to source of origin.'" *Id.*, (quoting *Syntex Laboratories, Inc. v. Norwich Pharmacal Co.*, 437 F.2d 566, 568 (2d Cir. 1971)) (emphasis in original).

121. *Id.*

122. *Id.* at 711.

123. *Id.* at 710.

124. *Id.* at 711.

125. *Id.* at 712.

126. The *Katzel* Court recognized that the trademark owner in the United States had a distinct goodwill associated with the trademark, which merited protection. 260 U.S. at 692.

a reasonable interpretation of section 526 and therefore deny protection to a single international enterprise.<sup>127</sup> A less absolute approach was taken in *Vivitar v. United States Customs*, when that court ruled that the Customs' Regulations do not define the limits of section 526 coverage but merely offer a guideline as to when Customs will enforce section 526.<sup>128</sup> Finally, some cases reject Customs' Regulations outright and enforce section 526 in all cases.<sup>129</sup> The following discussion concludes that the latter interpretation is the correct one.

The court in *Parfums Stern, Inc. v. United States Customs Service* denied protection to the authorized importer under the related parties exception to section 526.<sup>130</sup> The district court denied a motion for a preliminary injunction to protect the United States trademark owner from grey-market imports of perfume from France.<sup>131</sup> The plaintiff was the exclusive distributor and trademark owner of the perfume, but the court ruled that because the manufacturer and importer were commonly held companies the related parties exception to section 526 applied. *Parfums* relied on Customs' Regulations and concluded that the fears outlined in *Guerlain* were relevant here.<sup>132</sup> No discussion was devoted to the quality of the grey-market perfume or the goodwill developed in the United States by the trademark holder because the court presumed this to be left to a trademark infringement claim. The court's narrow view of section 526 was inspired by an attachment to ambiguous legislative history and the now discredited rationale of *Guerlain*.<sup>133</sup>

A different interpretation of Customs' Regulations section 133.21 was recently made in *Vivitar v. United States Customs*.<sup>134</sup> *Vivitar* filed suit in an attempt to compel Customs to enforce section 526 without exception. The Court of International Trade ruled that Customs could not be forced to exclude all grey-market goods<sup>135</sup> and the court of appeals affirmed.<sup>136</sup> Nevertheless, the *Vivitar* court's support for the regulations was narrow. The court of appeals engaged in an exhaustive analysis of legislative intent and past administrative interpretation of section 526.<sup>137</sup> The court concluded that there could be no related parties limitation read into the statute on the basis of

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127. See *infra* notes 130-33 and accompanying text.

128. See *infra* notes 134-42 and accompanying text.

129. See *infra* notes 155-71 and accompanying text.

130. 575 F. Supp. 416 (S.D. Fla. 1983).

131. *Id.* at 418.

132. The *Parfums* court in referring to *Guerlain* wrote that "[i]n that case, as in this one, there was a strong relationship between the domestic trademark-holding importer and the foreign manufacturer and an attempt by the domestic importer to monopolize the importation of the foreign manufacturer's goods into the United States." *Id.* at 420.

133. *Id.*

134. 761 F.2d 1552 (Fed. Cir. 1985).

135. *Vivitar Corp. v. United States Customs*, 593 F. Supp. 420 (Ct. Int'l Trade 1984).

136. *Vivitar*, 761 F.2d 1552.

137. *Id.* at 1561-68.

congressional intent.<sup>138</sup> Judge Nies ruled that while Customs' Regulations are a valid and reasonable exercise of administrative enforcement of section 526 they are not determinative of its scope.<sup>139</sup> The court found that historical interpretations of section 526 were marked by attempts to adjust the Regulations to current judicial decisions.<sup>140</sup> Even though the *Vivitar* court upheld section 133.21, it left the door open for a stricter application of section 526. The court ruled that even if Customs did not enforce section 526, the markholder might still have a private right of action under that section.<sup>141</sup> The court stated that if the section 526 claim is sustained in a private action the court can force Customs to exclude the goods.<sup>142</sup>

Despite the result in *Parfums*, other cases that uphold the Customs' Regulations do so in the qualified manner that *Vivitar* does. In another episode involving the camera industry the court in *Olympus Corp. v. United States* upheld the Regulations.<sup>143</sup> Olympus filed suit seeking declaratory and injunctive relief from the Regulations.<sup>144</sup> Olympus is the authorized importer of Japanese-manufactured cameras and accessories with exclusive rights to distribution. The case stemmed from Olympus brand sales made by the discount houses, 47th Street Photo and K-Mart.<sup>145</sup>

The *Olympus* court took a positive step forwards in recognizing, as the *Parfums* court did not, that the antitrust concerns supporting *Guerlain* and the Customs' Regulations are weak.<sup>146</sup> The court, however, found another justification with which to uphold the Regulations. It wrote: "While we find the regulation[s] of questionable wisdom, we believe that congressional acquiescence in the longstanding administrative interpretation of the statute legitimates that interpretation as an exercise of Customs' enforcement discretion."<sup>147</sup> While congressional acquiescence has been the rule, a longstanding interpretation of the statute has not. The court in *Vivitar* pointed out in great detail the changes in the interpretation of the statute over the years.<sup>148</sup>

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138. *Id.* at 1565.

139. *Id.* at 1571.

140. *Id.* at 1566. See also *supra* note 43.

141. "Accordingly, we hold the current regulations to be valid but not controlling with respect to the scope of protection of 19 U.S.C. 1526(a)." *Vivitar*, 761 F.2d at 1570.

142. The *Vivitar* court concluded by writing: "To obtain any additional protection, Vivitar must first pursue a determination of its alleged rights against persons engaging in parallel importation of VIVITAR photographic equipment in federal district court, and, if successful, is entitled to have the parallel imports excluded by Customs." *Id.*

143. 792 F.2d 315 (2d Cir. 1986).

144. *Id.* at 316.

145. *Id.* at 317.

146. The court wrote that prior to 1972, antitrust considerations supported Customs' Regulations. The decision in *Continental T.V., Inc. v. GTE Sylvania Inc.*, 433 U.S. 36 (1977), however, prompted the court to conclude that it "would seem to make reassessment of section 133.21(c) appropriate at least insofar as those regulations rest on antitrust considerations." *Olympus*, 792 F.2d at 319-20.

147. *Id.* at 320.

148. *Vivitar*, 761 F.2d at 1561-68. See also *supra* text accompanying notes 137-40.

The clear words of the statute state that all grey-market goods must be excluded by Customs.<sup>149</sup> Many courts have relied upon the legislative history surrounding the passage of 526 as support for denying protection for related parties. The legislative history, however, is not conclusive.<sup>150</sup> The floor debate was brief and the debate revealed that there were varying reasons for the passage of the bill.<sup>151</sup>

While section 526 may have been passed in response to the decision at the appellate court level in *Katzel*, the courts have misplaced their emphasis on the reversal of that decision in the Supreme Court. For example, *Parfums* assumed trademark protection is only to be given to an entity that has purchased the business and trademarks from the foreign manufacturer.<sup>152</sup> The form of the transaction by which the importer gained dominion over the trademark, however, is unrelated to the real goal of trademark protection under section 526. The Supreme Court did not emphasize the form of the arrangement between the manufacturer and the domestic trademark owner. The Court ruled that the goodwill the markholder had developed was distinct from that in France and that it was being infringed by grey-market imports.<sup>153</sup> The *Parfums* court's adherence to the related parties argument and failure to acknowledge the existence of the distinct goodwill is mistaken.

Judge Winter, dissenting in *Olympus*, also found the longstanding interpretation justification to be less than satisfactory. Winter wrote:

[T]he history of the regulation itself reflects the Customs Service's own confusion over the purpose and validity of the regulation. The Service waited some thirteen years before enacting one version of it and then relied for the statutory basis on the Lanham Act's predecessor rather than on Section 526. Since then, the reasons given by the Service in support of the regulation have varied, and even now considerable doubt exists as to precisely what relevant policy it is intended to implement. Congress's supposed long-standing acquiescence, therefore, is of little weight in view of the lack of continuity in the Service's rationale.<sup>154</sup>

149. See *supra* note 42 for the text of § 526.

150. The *Parfums* court, for example, relied on Congressional intent to narrow the scope of § 526. 575 F. Supp. at 420. The court in *Vivitar*, however, concluded that "no limitations based on indications of Congressional intent at the time of the enactment can be read into the statute." *Vivitar*, 761 F.2d at 1565.

151. See 62 CONG. REC. 11, 602-05 (1922). Moreover, Judge Nies wrote in *Vivitar*:

Under these circumstances, the remarks of one or more Senators are an unreliable indication of the sense of the chamber as a whole or of Congress. The only clear indication from the debate is that Congress realized it was providing a bar to importation even though at least one circuit (the *Katzel* court) would hold that the concurrent use of the mark on the parallel import would not be an infringement.

761 F.2d at 1563. Some of the force behind the passage of § 526 came from the post World War I acquisition of trademarks by United States companies with manufacturing sources or contacts in Germany. *Id.* at 1562.

152. *Parfums*, 575 F. Supp. at 419.

153. *Katzel*, 260 U.S. at 691.

154. *Olympus*, 792 F.2d at 322.

Judge Winter's dissent illustrates the misleading nature of the *Olympus* court's claim that the Customs Service has made a longstanding administrative interpretation of the statute. While the Customs Service has been interpreting the statute for a long period of time, it is clear that no consistent policy has been followed by Customs in its interpretations.

A move towards unqualified enforcement of section 526 was taken in *Weil Ceramics & Glass, Inc. v. Dash*.<sup>155</sup> The court followed the *Vivitar* court's interpretation of section 133.21 by saying that the Regulations merely outline Customs' role in initiating administrative action under the statute.<sup>156</sup> If Customs does not exclude the goods under section 526 on its own initiative, the trademark owner can use section 526 in a private action regardless of the related companies exception of section 133.21.<sup>157</sup> In *Weil*, the court found that section 526 had been violated, giving protection to Weil even though Weil and the Spanish manufacturer were commonly owned companies.<sup>158</sup> The court took the position that the related company exception to section 526 enforcement was unsound and resulted in many grey-market imports that damaged the domestic goodwill of the trademark owner. The court rejected the formalistic approach of section 133.21 and concluded that protection should always be given to a United States trademark holder when it has developed an independent goodwill.<sup>159</sup> This protection should be granted regardless of the form of the relationship between the importer and manufacturer.<sup>160</sup>

The *Vivitar* court noted the fact that administrative interpretations of section 526 have traditionally tried to be consistent with current judicial decisions.<sup>161</sup> Considering the recent criticism of *Guerlain* and the rationale underlying section 133.21 judicial decisions now lead to a broader interpretation of section 526.<sup>162</sup> Because of the recent developments in antitrust law, it appears that the free-rider problems associated with grey-market imports clearly outweigh any potential antitrust violation perpetuated by their exclusion.<sup>163</sup> Additionally, the antitrust laws are better suited to deal with the possibility of price discrimination than are trademark laws.

The decision in *Vivitar* also suggested a more restrictive policy towards grey-market imports by concluding that when Customs does not exclude the grey goods under section 526 the trademark owner can bring an action under

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155. 618 F. Supp. 700 (D.N.J. 1985).

156. *Id.* at 717.

157. *Id.* at 718.

158. *Id.*

159. *Id.* at 713-14.

160. *Id.* at 710-11.

161. *Vivitar*, 761 F.2d at 1570. See also *supra* note 140.

162. See criticism of *Guerlain* in *Vivitar*, 761 F.2d at 1556. See also *supra* note 48.

163. See *supra* note 55 and accompanying text.

15 U.S.C. § 1114 or 15 U.S.C. § 1124.<sup>164</sup> The success of these two statutes in helping the trademark owner is based on a possible trademark infringement against the importer of the grey-market goods. An infringement will generally be found if the court considers and protects the goodwill function of trademark law. The fact that many courts are sustaining such trademark infringement actions under sections 1114 and 1124 indicates that Customs should interpret section 526 more broadly. If Customs would enforce section 526 the savings in time and litigation energy would be immense. Allowing the grey-market goods to be imported and then subject to a trademark infringement action forces the trademark holder to sustain a multitude of individual trademark infringement actions. Once the goods enter the country the grey-market importer may supply several retailers. The trademark owner usually has a difficult time identifying the grey-market importer and actions must be brought against each grey-market retailer.<sup>165</sup> Many times the trademark holder enjoins one grey-market importer only to find that another importer has taken his place.

The most recent disapproval of the Customs' Regulations came in an opinion by the D.C. Circuit in *Coalition to Preserve the Integrity of American Trademarks (COPIAT) v. United States*.<sup>166</sup> In *COPIAT*, a trade association filed suit against the Customs Service, seeking to have the Regulations declared invalid because they are inconsistent with section 526. The District Court held that the Customs' Regulations are a sufficiently reasonable interpretation of the statute.<sup>167</sup> The D.C. Circuit reversed, holding that the Regulations are inconsistent with the clear meaning of the statute.<sup>168</sup>

The *COPIAT* court's first point of analysis was the legislative history and intent of section 526. In refuting arguments that try to support the Regulations on the basis of legislative intent surrounding the passage of section 526, Judge Silberman wrote:

In light of the statute, its legislative history and purpose and the contemporaneous constructions placed upon it, we conclude that Section 526 simply cannot be limited in the manner that the Customs Service has attempted. Because Congress' intent on the issue at hand is apparent, we must give effect to that intent irrespective of current administrative interpretations. In Section 526, Congress defined the relevant statutory terms with precision and did not delegate authority, explicitly or implicitly, to the Customs Service to adjust the scope of the statute in response to its perceptions of changing economic circumstances. What the statute meant in 1922 and 1930 is what it means today.<sup>169</sup>

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164. *Vivitar*, 761 F.2d at 1569.

165. See *supra* note 9.

166. 790 F.2d 903 (D.C. Cir. 1986).

167. *Coalition to Preserve The Integrity of Am. Trademark (COPIAT) v. United States*, 598 F. Supp. 844 (D.D.C. 1984).

168. 790 F.2d at 905.

169. *Id.* at 913 (citations omitted).

This is the language that Judge Winter relied upon in his dissent in *Olympus*. It is a strong argument when compared to the *Olympus* court's "longstanding administrative interpretation" justification for an administrative rule that contradicts a statute.

The *COPIAT* court went on to assail the antitrust rationale for Customs' Regulations, a rationale that in recent years only the *Parfums* court had supported. After citing recent authority in the antitrust field that indicates that pro-competitive effects can result from some vertical restrictions,<sup>170</sup> the court noted that the Justice Department found no antitrust problems with a strict application of section 526.<sup>171</sup> The *COPIAT* court's reliance on the clear meaning of the statute has a solid foundation in comparison to the courts which rely on the vacillating interpretations of the Customs Service. Even if the statute provided for some degree of interpretation by the Customs Service the Regulations make for bad policy. There are no significant antitrust concerns, and the trademark principles illustrated above all support exclusion of grey-market goods.

Customs is the lowest cost enforcer of section 526. Because it already inspects goods at all points of entry, the extra cost of examining goods of related parties is minimal and could be financed through a registration fee paid by the trademark owner. If Customs can exclude the goods at the point of entry the grey-market importer cannot spread the goods throughout the market. A broad application of section 526 by Customs would provide a clear and unambiguous rule, an incentive to fairly develop domestic and foreign markets, and an incentive to promote high quality goods and services under a trademark.

If more courts properly recognize domestic goodwill as a trademark goal worthy of protection, then the lax application of section 526 by Customs will be inefficient. Considering the recent decisions that have acknowledged the domestic goodwill and the clear mandate from *Katzel* to do so, the Customs' Regulations should be changed.

#### IV. REFORMS IN GREY-MARKET POLICY

The present state of the law regarding grey-market goods is unsatisfactory. The inefficient and inconsistent manner in which the present case-by-case method is proceeding calls for legislative or executive reform. Possibilities

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170. *Id.* at 916.

171. The court wrote:

In fact, in a recent case the Justice Department—joined, significantly, by the Customs Service—filed an amicus brief arguing that Section 526 raised no antitrust concerns and *ought to be enforced according to its express terms*. See Brief of United States as Amicus Curiae, *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 719 F.2d 42 (2d Cir.1983).

*Id.* (emphasis in original).

for reform in the area can be broken down into four categories: (1) allowing all grey-market goods to be imported; (2) mandatory labeling of all grey-market goods as such; (3) mandatory demarking of all grey-market goods to eliminate brand name identification; or (4) preventing the importation of all grey-market goods.

Allowing all grey-market goods to enter the country is unwise. Individual trademark suits would overload the judiciary and possibly result in conflicting outcomes. This in turn would result in lower quality goods along with general confusion and inefficiency in the marketplace. The free-rider problems associated with grey-market imports are particularly harmful.<sup>172</sup> Unlimited entry of all grey-market imports is not, therefore, a viable alternative.

Labeling all grey-market goods is a complicated solution, the effectiveness of which is speculative.<sup>173</sup> Labeling grey-market goods could brand the goods as inferior in the eyes of the consumer. This would cause confusion because not all grey-market goods are, in fact, inferior. Moreover, statistics indicate that many consumers do not read the labels on products and in many cases brand identification is so strong that consumers will often ignore the label.<sup>174</sup> The effect of a labeling approach might cause enforcement problems that could well outweigh the benefits of changing from the present case-by-case approach to the problem. Also, labels can easily be removed.

One commentator advocates a demarking policy towards grey-market goods.<sup>175</sup> This procedure involves removal or obliteration of the trademark. While this procedure would solve the problems of trademark infringement, demarking is impossible in some cases. Many goods cannot be successfully demarked without resulting damage to the goods. After all, an "Izod" shirt with a hole instead of an alligator on the breast is not a highly marketable item. Some products are still identifiable despite the removal of the trademark. A Mercedes-Benz, for example, is likely to be recognized despite demarking. When the goods can still be identified according to the brand, the free-rider problem is not solved.

Banning all grey-market goods promotes the proper incentives to develop trademarks and high quality goods because the inherent free-rider problems are eliminated. Additionally, consumers will benefit because they know what to expect when they purchase on a brand name basis. Cases in which a trademark holder has not developed a distinct goodwill are undocumented and appear to be infrequent. Moreover, the damage done as a result of excluding grey-market goods when the trademark holder has not developed a distinct goodwill is insignificant.

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172. See *supra* notes 16-24 and accompanying text.

173. DeMuth, *Gray Market Compromise: Demarking v. Labeling 5* (September 1985) (unpublished paper by Lexecon Inc.).

174. *Id.*

175. *Id.*



## CONCLUSION

A total ban on grey-market imports is the most efficient policy solution. This ban should be accomplished through a vigorous enforcement of section 526. The benefits of having the goods excluded by the Customs Service and section 526, rather than having each trademark holder pursue litigation in different forums are pronounced. The marginal cost of the extra enforcement, considering the scope of Customs' duties at this time, is negligible. Excluding all parallel imports will promote the proper incentives under trademark law to develop and maintain high quality goods and promote consumer welfare.

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