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## The Graying of the American Manufacturing Economy: Gray Markets, Parallel Importation, and a Tort Law Approach

Ever wonder how you obtained that camera, television, or other product so cheaply? The most likely answer is that it came from a “gray market” source. Throughout the world, barriers to foreign trade are crumbling. International business transactions and deals fuel increased international free trade. An element of increased free trade that has been one of the most vexing and problematic areas for manufacturers is the phenomenon of “parallel” importation or “gray market” importation. In the United States alone, this problem costs American manufacturers billions of dollars each year.

Generally, gray market or parallel importation occurs when a third party purchases “genuine” U.S. trademarked or copyrighted goods, manufactured or distributed abroad, and imports and sells these goods in the United States without the consent of the American holder of the trademark or copyright. Gray market goods are distinguishable from black market goods (i.e., counterfeit or imitation goods) in that the U.S. trademark or copyright holder manufactures the goods or permits a foreign licensee to produce the goods according to established specifications. This Article examines the gray market or parallel importation (terms this Article uses interchangeably) as it impacts American manufacturers from three discrete legal perspectives: (1)

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trademark law, (2) customs law, and (3) copyright law. Further, this Article explores in depth the case law in the United States that has framed the gray market discussion. This Article concludes by recommending that American manufacturers turn to tort law as a solution to their gray market issues. Specifically, this Article advocates for the use of the tort of intentional interference with performance of contract by a third person as a means to combat the problem of gray market or parallel importation of goods.

As mentioned above, parallel importation generally occurs when a third party imports and sells U.S. trademarked or copyrighted goods, which were manufactured or distributed abroad, in the United States without the consent of the American holder of the trademark or copyright.<sup>1</sup> Each year, a plethora of genuine goods and products reach the shores of this country. Across a vast multitude of industry segments, the gray market is a multi-billion-dollar concern affecting domestic manufacturers. The Alliance for Gray Market and Counterfeit Abatement, a nonprofit organization founded in 2001 by 3Com, Cisco Systems, Hewlett-Packard, and Nortel, estimated that, in 2003, the gray market for information technology goods amounted to \$40 billion, costing information technology manufacturers upwards of \$5 billion annually in lost profits.<sup>2</sup> This is staggering considering the impact of the gray market on just one industry segment—here information technology. The gray market affects a number of other industry segments and products. Although statistics do not exist, the

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<sup>1</sup> As one authority has noted:

One of the most controversial areas of customs law concerns “gray market goods,” goods produced abroad with authorization and payment but which are imported into unauthorized markets. Trade in gray market goods has dramatically increased in recent years, in part because fluctuating currency exchange rates create opportunities to import and sell such goods at a discount from local price levels. Licensors and their distributors suddenly find themselves competing in their home or other “reserved” markets with products made abroad by their own licensees. Or, in the reverse, startled licensees find their licensor’s products intruding on their local market shares. In either case, third party importers and exporters are often the immediate source of the gray market goods, and they have little respect for who agreed to what in the licensing agreement. When pressed, such third parties will undoubtedly argue that any attempt through licensing at allocating markets or customers is an antitrust or competition law violation.

RALPH H. FOLSOM ET AL., *INTERNATIONAL BUSINESS TRANSACTIONS* 736 (2d ed. 2001).

<sup>2</sup> Alliance for Gray Market & Counterfeit Abatement, Resources: FAQ, [http://www.agmaglobal.org/resources/faq.shtml#gray market2](http://www.agmaglobal.org/resources/faq.shtml#gray%20market2) (last visited Mar. 23, 2010).

impact of the gray market across all industry segments worldwide is likely sizable.

Three discrete bodies of law are relevant in discussing gray market importation: (1) trademark law, (2) customs law, and (3) copyright law. This Article employs two lines of analysis in its examination of parallel importation. First, this Article analyzes parallel importation from the perspective of trademark and customs law. Second, this Article examines parallel importation under the doctrine of copyright law. Under the two discrete regimes of intellectual property law—trademark and copyright—gray market goods were once afforded differing treatments. In the United States, under Supreme Court precedent, trademark and copyright laws are now synchronized, and parallel importation is legal.

Rather than discuss all possible legal “solutions” to parallel importation or the propriety of its existence, this Article examines the history of the gray market in the United States through an analysis of both the domestic legislative framework and judicial treatment of gray market goods, primarily under trademark and copyright law. As a primary “solution” to the gray market problem, this Article examines and highlights tort law as a viable means available to concerned manufacturers to remedy gray market problems.

Part I of this Article provides a general introduction into the structural factors that cause parallel importation, such as currency fluctuation, price discrimination among markets and territories, and production and cost differentials in manufacturing products. Part I concludes by offering three models to illustrate how the gray market functions. Part II begins a discussion of trademarked goods by looking at the purposes of trademark law. Next, this Article explores both the historic underpinnings of the case law and the earliest statutory efforts to regulate parallel importation. Subsequently, Part II concludes the trademark discussion of parallel importation by looking at administrative and judicial interpretations and exceptions that have allowed the practice of parallel importation under customs law.

Using American copyright law as a lens, Part III starts by discussing the relevant doctrines and provisions of the Copyright Act of 1976, which frame the gray market discussion. Part III examines both the early gray market case law that caused a split of authority among the federal circuit courts of appeal and the pivotal U.S. Supreme Court decision, *Quality King Distributors v. L'anza Research International, Inc.*, which opened the way for the legal

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parallel importation of gray market goods. Part III concludes by examining the current debate and the unanswered question in *Quality King Distributors*, the analysis of which is currently pending before the U.S. Supreme Court in *Omega S.A. v. Costco Wholesale Corp.* Finally, Part IV concludes by examining possibly the last viable means to exclude gray market goods from the United States: a tort action for intentional interference with performance of a contract by a third person.

## I

### FACTORS THAT CAUSE GRAY MARKETS

#### A. *Currency Fluctuations*

In answering why gray markets occur and exist, the easiest and first answer is currency fluctuation. Profit maximization is the engine that drives business in the capitalist world. In the international trade context, with the ebb, tide, and flow of currency fluctuations, it becomes extremely advantageous to purchase large quantities of products from a nation with a weakly valued currency and import those same products to nations with a more strongly valued currency.

To illustrate this point, assume that the U.S. dollar has hypothetically become relatively strong in relation to its Asian counterparts like the Japanese yen, the Hong Kong dollar, and the South Korean won. With a downturn in these Asian currencies, it is lucrative to purchase a vast array of items from the Asian countries and import these products to the United States to undercut higher-priced U.S. products.

In politics, political strategist James Carville is credited with coining the phrase "It's the economy, stupid!" in Bill Clinton's 1992 presidential campaign against George H.W. Bush.<sup>3</sup> In the gray market context, the saying goes like this: "It's the exchange rate, stupid!"

To further illustrate the above example, assume that a South Korean manufacturer produces high-end cameras. The South Korean camera manufacturer has an extensive U.S. distribution system in place whereby American distributors/licensees sell its cameras to retail establishments. The South Korean camera manufacturer charges its distributors/licensees \$100 per camera at wholesale. In

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<sup>3</sup> See Louis Uchitelle, *Flat Wages Seen as Issue in '96 Vote*, N.Y. TIMES, Aug. 13, 1995, at A26.

addition to the American distributors/licensees, the South Korean camera manufacturer has an extensive worldwide market and distribution system, including Japan where the company sells cameras to its distributors/licensees for the equivalent, convertible sum of \$100. Further, assume that both the American and Japanese distributors/licensees mark up the price charged to retailers by twenty-five percent per camera. Finally, assume that the price to import goods (shipping, packaging, and customs tariffs and duties) to the United States from Japan is ¥10. In the end, the American distributors and licensees sell the camera to the retailer for \$125 (\$100 per unit + \$25 markup = \$125), while the Japanese distributors and licensees sell to the retailer for, hypothetically, ¥125.

Where the currency exchange rates are at a ratio of 1:1, parallel importation is economically inefficient. Both products are priced the same when the currencies are converted (\$125). In addition, the Japanese distributors/licensees would have to pay \$10 extra to import cameras to the United States, for a grand total of \$135 (\$100 per unit + \$25 markup + \$10 shipping = \$135). This scenario would not allow the Japanese distributor/licensee to have a cost advantage in relation to its American counterpart.

Tinker with the facts for a moment, and a different result becomes readily apparent. If the exchange rate between dollars and yen changed to a ratio of 1:2, namely  $\$1 = ¥2$ , then a gray market situation would be born. Assume the South Korean camera manufacturer would still charge \$100 and ¥100 respectively to its American and Japanese distributors/licensees. Assume further that the shipping costs remain ¥10 (now converted to \$5 with the new exchange rate). As a result of the currency fluctuation, the Japanese distributors/licensees cost (with retail markups included) for the South Korean camera would be equal to \$62.50 ( $¥125 = \$62.50$  at a  $\$1:¥2$  currency exchange rate). With shipping costs at \$5 (¥10), the total cost to sell the South Korean camera from Japan into the United States becomes \$67.50. The American distributors' and licensees' relative cost to sell its product in the United States becomes \$75. By importing into the United States, the Japanese distributor/licensee nets a profit of \$7.50 per unit sold ( $\$75.00 - \$67.50 = \$7.50$ ) resulting from the parallel importation.

Profit maximization is the energy that fuels business. So, in the international context, a gray market importer gains from currency fluctuations.

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*B. Price Discrimination in Markets and Territories*

Another reason the gray market exists is directly related to the pricing behavior of manufacturers in various markets. Often, when a manufacturer produces a product it prices that product for an intended “audience” based on the audience’s ability to pay for the good. There is broad variation of product placement within markets. A manufacturer may produce a product to appeal to the discount market, the middle-range market, or the luxury market. In terms of international trade, at the microeconomic strata, the ability of market participants to pay the price charged for an item governs the initial pricing decision. This is particularly true in the modern economy, in which multinational corporations have become adept at controlling manufacturing costs and have dominant positions in terms of “market power” within individual economies.<sup>4</sup>

To illustrate, say it costs a U.S. widget manufacturer, McWidget, \$25 to manufacture its widget. In setting a palatable market price, McWidget may charge Americans \$250 per piece for its widgets, drawing comfort from the fact that the average American has the ability and resources to pay such a premium price. In Mexico, due to harsher economic circumstances, McWidget may charge \$50 for the same widget. In Germany, where the economy is finely tuned, McWidget might price its widgets at \$150. In Japan, McWidget might charge \$200 for the widget because the Japanese consumer has the ability to pay, much like the American consumer. Finally, in Hong Kong, McWidget might choose to price the widget at \$175. These examples demonstrate that price is largely driven by market forces—or the ability of consumers to pay for a particular product—and as a result of those market forces, manufacturers exercise a great deal of discretion within the confines of the market with respect to their pricing behavior.

Few courts have paid much attention to price discrimination among markets. However, in *NEC Electronics v. CAL Circuit Abco*, a gray market case, the U.S. Court of Appeals for the Ninth Circuit made a bold statement against the very sort of discrimination that fuels gray markets. The court wrote:

If NEC-Japan chooses to sell abroad at lower prices than those it could obtain for the identical product here, that is its business. In

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<sup>4</sup> See generally Richard M. Andrade, Comment, *The Parallel Importation of Unauthorized Genuine Goods: Analysis and Observations of the Gray Market*, 14 U. PA. J. INT’L BUS. L. 409, 415–16 (1993).

doing so, however, it cannot look to United States trademark law to insulate the American market or to vitiate the effects of international trade. This country's trademark law does not offer NEC-Japan a vehicle for establishing a worldwide discriminatory pricing scheme simply through the expedient of setting up an American subsidiary with nominal title to its mark.<sup>5</sup>

### *C. Production and Cost Differences Between Nations*

A final explanation for gray market occurrence can be found in production and other cost differentials associated with producing goods in more than one market. Differentials in raw material costs, labor costs, marketing and advertising costs, utility costs, fuel costs, plant efficiency, tax liability, governmental and regulatory compliance costs, and government subsidies and price supports, among other factors, may govern how much it costs to provide a good to consumers in a particular market.<sup>6</sup> These factors may determine the ultimate price that consumers have to pay for goods in a specific market, not price discrimination. Manufacturing activity in a high-cost environment may require upward price adjustment.<sup>7</sup> Conversely, manufacturing in a low-cost environment may require the opposite, price deflation. “[P]rice differentials that give rise to the gray markets occur because of cost considerations largely outside the control of the manufacturer . . . .”<sup>8</sup>

### *D. Three Contexts in Which the Gray Market Arises*

The gray market can arise in three general contexts. In case 1, a U.S. firm purchased the rights to register and use the trademark or copyright of foreign-manufactured products and sells these products in the United States.<sup>9</sup> The U.S. firm discovers that the foreign firm is importing the trademarked goods and distributing them in the United States itself or selling them to a third party abroad who imports them to the United States.<sup>10</sup> In this scenario, the U.S. trademark purchaser is known as the “gray-market victim.”<sup>11</sup>

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<sup>5</sup> *NEC Elecs. v. CAL Circuit Abco*, 810 F.2d 1506, 1511 (9th Cir. 1987).

<sup>6</sup> *Andrade*, *supra* note 4, at 416–17.

<sup>7</sup> *Id.* at 417.

<sup>8</sup> *Id.*

<sup>9</sup> *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 286 (1988).

<sup>10</sup> *Id.*

<sup>11</sup> *See id.*

Case 2, the most common gray market scenario, occurs when a U.S. firm registers the U.S. trademark for goods that are manufactured by an affiliated manufacturer abroad.<sup>12</sup> In a standard variation (case 2A), a foreign firm that wishes to control distribution of its product in the United States incorporates a subsidiary in the United States.<sup>13</sup> Then, the subsidiary registers under its own name (or the name the foreign firm/manufacturer assigns to the subsidiary), a U.S. trademark identical to the foreign parent's trademark.<sup>14</sup> "The parallel importation by a third party who buys the goods abroad (or conceivably even by the affiliated foreign manufacturer itself) creates a gray market."<sup>15</sup> Two other variations of this theme may occur when an American-based company establishes a manufacturing subsidiary corporation abroad (case 2B) or its own unincorporated manufacturing unit (case 2C) to produce trademarked goods, "and then imports them for domestic distribution."<sup>16</sup> When the foreign subsidiary or the trademark owner sells the trademarked or copyrighted goods abroad, "the parallel importation of the goods competes on the gray market with the [trademark or copyright] holder's domestic sales."<sup>17</sup>

Finally, in case 3, a U.S. holder of a trademark or copyright may authorize an independent foreign manufacturer to make its products.<sup>18</sup> Usually, the U.S. trademark or copyright holder sells or assigns to the foreign manufacturer an exclusive right to use the trademark or copyright in a particular foreign market, thus conditioning the right of use on the foreign manufacturer's promise not to import the product into the United States.<sup>19</sup> Again, if the foreign manufacturer or a third party imports the goods into the United States, the foreign-manufactured goods compete on the gray market with the U.S. trademark or copyright holder's domestically produced goods.<sup>20</sup>

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<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup> *Id.*

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at 286–87.

<sup>17</sup> *Id.* at 287.

<sup>18</sup> *Id.*

<sup>19</sup> *Id.*

<sup>20</sup> *Id.*



## II

VIEWING THE GRAY MARKET THROUGH THE LENS OF TRADEMARK  
AND CUSTOMS LAW*A. The Purposes of Trademark Law*

In 1870, Congress passed the first federal law regulating trademark registration.<sup>21</sup> However, just nine years later, in 1879 the U.S. Supreme Court held the Act unconstitutional because it exceeded Congress's power to regulate trademarks, limited by the Commerce Clause.<sup>22</sup> Congress responded in 1881 by passing a new statute governing registration of trademarks used in commerce with the Indian tribes and foreign nations, but leaving out interstate commerce.<sup>23</sup> It was not until 1905 that Congress passed the Federal Trademark Act, which is regarded as the first "modern" federal trademark registration statute.<sup>24</sup> The Act was subjected to a series of amendments and modifications,<sup>25</sup> and by today's standards, the original 1905 legislation was fairly limited.<sup>26</sup>

The Lanham Trademark Act of 1946 codified contemporary principles of American trademark law.<sup>27</sup> "For the first time, Congress had passed a law creating substantive, as well as procedural, rights in trademarks and unfair competition."<sup>28</sup> From a public policy perspective, the Lanham Trademark Act of 1946 was intended to provide trademark owners with goodwill by providing consumers the ability to distinguish among goods of competing manufacturers.<sup>29</sup> In essence, the Act's stated purpose was "'to codify and unify the common law of unfair competition and trademark protection.'"<sup>30</sup>

According to one authority, trademarks generally perform four functions:

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<sup>21</sup> 1 J. THOMAS MCCARTHY, MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 5.3, at 5-6 (4th ed. 2002).

<sup>22</sup> *Id.* at 5-7 (citing *Trade-Mark Cases*, 100 U.S. 82 (1879)).

<sup>23</sup> *Id.* at 5-7 to 5-8.

<sup>24</sup> *Id.* at 5-8.

<sup>25</sup> *Id.* at 5-8 to 5-9.

<sup>26</sup> *Id.* at 5-8.

<sup>27</sup> *Id.* at 5-9 to 5-13.

<sup>28</sup> *Id.* at 5-13.

<sup>29</sup> *Id.*

<sup>30</sup> *Id.* (quoting *Inwood Labs., Inc. v. Ives Labs., Inc.*, 456 U.S. 844, 861 n.2 (1982) (White, J., concurring)).

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1. [t]o identify one seller's goods and distinguish them from goods sold by others; . . . 2. [t]o signify that all goods bearing the trademark come from . . . a single, albeit anonymous, source; . . . 3. [t]o signify that all goods bearing the trademark are of an equal level of quality; . . . and 4. [a]s a prime instrument in advertising and selling the goods.<sup>31</sup>

In addition to the four functions mentioned above, the following merits consideration:

[I]t must also be kept in mind that a trademark is also the objective symbol of the good will that a business has built up. . . . Without the identification function performed by trademarks, buyers would have no way of returning to buy products that they have used and liked. If this consumer satisfaction and preference is labeled "good will," . . . then a trademark is the symbol by which the world can identify that good will.<sup>32</sup>

The test of infringement in trademark is whether the mark in question creates a likelihood of confusion, mistake, or deception.<sup>33</sup>

There are two competing theories of trademark rights: (1) the universality theory and (2) the territoriality theory. "[B]ased on universality, the trademark represents the good on a world-wide basis."<sup>34</sup> "Territoriality provides the trademark holder with a separate set of rights and protections in each individual country in which the trademark is registered."<sup>35</sup>

*B. First Judicial Encounters with the Gray Market: Apollinaris Co. v. Scherer*

The first American case dealing with parallel importation arose in 1886 in New York. In *Apollinaris Co. v. Scherer*, Andreas Saxlehner, the owner of a mineral spring in Hungary, entered into an exclusive contract with the Apollinaris Company to export and sell waters from springs in Great Britain and America.<sup>36</sup> The waters were known as Hunyadi Janos and were trademarked under that name.<sup>37</sup> "The waters are known as 'Hunyadi Janos,' the spring having been christened by that name by Saxlehner, and the name as applied to the water having

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<sup>31</sup> *Id.* at 3-3 (footnotes omitted).

<sup>32</sup> *Id.* (footnotes omitted).

<sup>33</sup> *See id.* at 3-5 to 3-11.

<sup>34</sup> Andrade, *supra* note 4, at 425.

<sup>35</sup> *Id.*

<sup>36</sup> *Apollinaris Co. v. Scherer*, 27 F. 18, 19 (C.C.S.D.N.Y. 1886).

<sup>37</sup> *Id.*

been adopted by [Saxlehner] as a [trademark].”<sup>38</sup> To protect their prospective rights, Saxlehner and Apollinaris Co. adopted labels to be affixed to their bottles bearing the Hunyadi Janos name.<sup>39</sup> To further protect their rights, Saxlehner’s labels contained the following warning: “CAUTION. This bottle is not intended for export, and if exported for sale in Great Britain, her colonies, America, or other transmarine places, the public is cautioned against purchasing it. ANDREAS SAXLEHNER.”<sup>40</sup>

In place of Saxlehner’s cautionary notice, Apollinaris Co. placed its own notice on the bottles, stating the following: “Sole exporters. The Apollinaris Company, Limited, London.”<sup>41</sup>

Saxlehner proceeded to sell Hunyadi Janos water in Germany and other parts of the continent in bottles bearing his label.<sup>42</sup> Apollinaris Co., in bottles bearing its label, sold Hunyadi Janos in Great Britain and the United States. Apollinaris established an agency in the United States to aid in its American distribution.<sup>43</sup> Soon, Scherer began purchasing Hunyadi Janos in continental Europe and exporting it to America, where he sold it at prices lower than Apollinaris’s.<sup>44</sup>

In denying Apollinaris’s motion for a preliminary injunction, the court held that because the item in question, Hunyadi Janos water, was a genuinely trademarked product, Apollinaris’s trademark had not been infringed. The court opined that if Scherer were importing a counterfeit product a different result would be in order: an injunction.<sup>45</sup>

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<sup>38</sup> *Id.*

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

<sup>41</sup> *Id.*

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> *Id.* Judge Wallace points out that Scherer “does this after having applied to Saxlehner to sell him the water and b[eing] refused and informed by Saxlehner of the [Apollinaris’s] rights.” *Id.*

<sup>45</sup> *Id.* at 20 (“There is no exclusive right to the use of a name or symbol or emblematic device except to denote the authenticity of the article with which it has become identified by association. The name has no office except to vouch for the genuineness of the thing which it distinguishes from all counterfeits; and until it is sought to be used as a false token to denote that the product or commodity to which it is applied is the product or commodity which it properly authenticates, the law of trade-mark cannot be invoked.”).

*C. The Decision that Set the Tone of Debate: A. Bourjois & Co. v. Katzel*

Beginning in 1879, successeurs (A. Bourjois & Cie.) sold face powder manufactured in France in the United States.<sup>46</sup> A. Bourjois & Cie., a French company, registered its face powder under the U.S. trademark “Java” in 1888.<sup>47</sup> It registered the company’s trademark, “A. Bourjois & Cie.,” in 1908.<sup>48</sup> Finally, A. Bourjois & Cie. registered the trademark “Java” on the top and side of its face powder box in 1912.<sup>49</sup>

In 1913, A. Bourjois & Co., Inc. (A. Bourjois NY), a New York corporation, bought the U.S. business, goodwill, and trademarks of A. Bourjois & Cie., E. Wertheimer & Cie., Successeurs.<sup>50</sup> Under the terms of the assignment and purchase of the U.S. business and trademarks, A. Bourjois NY imported face powder purchased from A. Bourjois & Cie. in bulk from France.<sup>51</sup>

Anna Katzel owned and operated a retail pharmacy in New York City, from which she sold, in several states, “the same genuine face powder manufactured by the French firm, imported by her in its original boxes, on which are printed its trade-marks and labels.”<sup>52</sup> A. Bourjois NY filed an action in Federal District Court alleging that Katzel infringed its registered trademark.<sup>53</sup> The A. Bourjois & Cie., E. Wertheimer & Cie., Successeurs powder that Katzel sold was called “Poudre de riz de Java,” which A. Bourjois NY also called it until 1916, while A. Bourjois NY’s powder was called “Poudre Java.”<sup>54</sup> In addition, on the bottom of A. Bourjois NY’s box was the following caption: “Trade-Mark Reg. U.S. Pat. Off. Made in France—Packed in the U.S.A. by A. Bourjois & Co., Inc., of N.Y., Succ’rs in the U.S. to A. Bourjois & Cie. and E. Wertheimer & Cie.”<sup>55</sup> The district court granted A. Bourjois NY’s motion for a

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<sup>46</sup> A. Bourjois & Co. v. Katzel, 275 F. 539, 539 (2d Cir. 1921), *rev’d*, 260 U.S. 689 (1923).

<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

<sup>49</sup> *Id.*

<sup>50</sup> *Id.* at 539–40.

<sup>51</sup> *Id.*

<sup>52</sup> *Id.* at 540.

<sup>53</sup> *See id.* at 540.

<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

preliminary injunction because Katzel's importation infringed A. Bourjois NY's trademarks.<sup>56</sup> Katzel appealed to the U.S. Court of Appeals for the Second Circuit.<sup>57</sup>

The Second Circuit reversed the district court's decision.<sup>58</sup> The Second Circuit "set on one side all authorities cited [by A. Bourjois NY] arising out of sales under the same trade-marks of two different competitive articles manufactured by different persons."<sup>59</sup> The court's rationale was that because there were no legal grounds on which to hold that A. Bourjois NY's trademarks had been infringed, "the article sold by the plaintiff and covered by its registered trade-marks is the face powder actually manufactured by the French firm, imported in bulk and packed here by the plaintiff, which is the precise article imported by the defendant in the French firm's original boxes and sold here."<sup>60</sup> After discussing the case law from the Second Circuit related to trademarks,<sup>61</sup> the court offered the following observation:

Trade-marks . . . are intended to show without any time limit the origin of the goods they mark, so that the owner and the public may be protected against the sale of one man's goods as the goods of another man. If the goods sold are the genuine goods covered by the trade-mark, the rights of the owner of the trade-mark are not infringed.<sup>62</sup>

The debate was not over. The Second Circuit certified the question involved in *A. Bourjois & Co. v. Katzel* to the U.S. Supreme Court.<sup>63</sup>

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<sup>56</sup> *See id.*

<sup>57</sup> *See id.*

<sup>58</sup> *Id.* at 543.

<sup>59</sup> *Id.* at 540. A. Bourjois NY cited to *Hanover Milling Co. v. Metcalf*, 240 U.S. 403 (1916), and *Scandinavia Co. v. Asbestos Co.*, 257 F. 937 (2d Cir. 1919). *Id.*

<sup>60</sup> *Id.*

<sup>61</sup> *Id.* at 540–43. The Court discussed *Apollinaris Co. v. Scherer*, 27 F. 18 (C.C.S.D.N.Y. 1886), *Russian Cement Co. v. Frauenhar*, 133 F. 518 (2d Cir. 1904), and *Gretsch Manufacturing Co. v. Schoening*, 238 F. 780 (2d Cir. 1916). *Id.*

<sup>62</sup> *Id.* at 543.

<sup>63</sup> *Id.* at 544 (per curiam).

The precise question decided by us has been misapprehended. The trade-marks and labels complained of are those of the French house, and the plaintiff asserts that it is selling under them face powder manufactured by the French house in France and imported by it in bulk and repacked here. It treats this repacking as a very material consideration. The defendant says that this is precisely the product made by the French house in France and imported by her in the boxes of the French house with the same trade-marks and labels, which she is selling here.

*Id.*

In a remarkably terse three-paragraph opinion, Justice Holmes announced the decision of the Court, reversing the Second Circuit and reinstating the district court's finding of infringement and grant of preliminary injunction.<sup>64</sup>

After briefly recounting the facts,<sup>65</sup> the Court held that under the then-controlling statute authorizing assignment,<sup>66</sup> "[a]fter the sale the French manufacturers could not have come to the United States and have used their old marks in competition with the plaintiff."<sup>67</sup> Thus, by selling to Katzel and by directly and indirectly competing against its assignee, A. Bourjois & Cie. and Katzel, by implication, infringed upon the trademark rights of A. Bourjois NY. The Court embraced the "territoriality" theory of trademark.<sup>68</sup> The "territoriality" theory of trademark provides that "[a] U.S. [trademark] registration provides protection only in the United States and its territories."<sup>69</sup>

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<sup>64</sup> A. Bourjois & Co. v. Katzel, 260 U.S. 689, 690–93 (1923).

<sup>65</sup> *Id.* at 691 ("The defendant, finding that the rate of exchange enabled her to do so at a profit, bought a large quantity of the same powder in France and is selling it here in the French boxes which closely resemble those used by the plaintiff . . . There is no question that the defendant infringes the plaintiff's rights unless the fact that her boxes and powder are the genuine product of the French concern gives her a right to sell them in the present form.").

<sup>66</sup> *Id.* (citing Act of February 20, 1905, ch. 592, § 10, 33 Stat. 727).

<sup>67</sup> *Id.*

<sup>68</sup> *See id.* at 692 ("Ownership of the goods does not carry the right to sell them with a specific mark. It does not necessarily carry the right to sell them at all in a given place. If the goods were patented in the United States a dealer who lawfully bought similar goods abroad from one who had a right to make and sell them there could not sell them in the United States. . . . The monopoly in that case is more extensive, but we see no sufficient reason for holding that the monopoly of a trade mark, so far as it goes, is less complete. It deals with a delicate matter that may be of great value but that easily is destroyed, and therefore should be protected with corresponding care. It is said that the trade mark here is that of the French house and truly indicates the origin of the goods. But that is not accurate. It is the trade mark of the plaintiff only in the United States and indicates in law, and, it is found, by public understanding, that the goods come from the plaintiff although not made by it. . . . It stakes the reputation of the plaintiff upon the character of the goods." (citations omitted)).

<sup>69</sup> MARGARET C. JASPER, *THE LAW OF TRADEMARKS* 10 (1999); *see also* Andrade, *supra* note 4, at 424–27.

*D. Congress Responds to the Gray Market: Legislative and  
Administrative Efforts to Stop Parallel Importation*

*1. Section 526 of the Fordney-McCumber Tariff Act of 1922*

Congress entered the debate on parallel importation by enacting section 526 of the Fordney-McCumber Tariff Act of 1922.<sup>70</sup> Section 526(a) of the Act provides that

it shall be unlawful to import into the United States any merchandise of foreign manufacture if such merchandise, or the label, sign, print, package, wrapper, or receptacle, bears a trademark owned by a citizen of, or by a corporation or association created or organized within, the United States, and registered in the Patent and Trademark Office by a person domiciled in the United States . . . .<sup>71</sup>

Congress enacted section 526 with the full intent of overturning the Second Circuit's holding in *Katzel*. In Congress's view, the Fordney-McCumber Tariff Act was a measure to protect American manufacturers and industry from unfair competitive advantages inhering to foreign manufacturers and industry.<sup>72</sup> Section 526 was

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<sup>70</sup> Fordney-McCumber Tariff Act of 1922, ch. 356, § 526, 42 Stat. 975, *repealed by* Smoot-Hawley Tariff Act of 1930, ch. 497, § 526, 46 Stat. 590, 741 (current version at 19 U.S.C. § 1526 (2006)).

<sup>71</sup> 19 U.S.C. § 1526(a) (2006).

<sup>72</sup> *See* S. REP. NO. 67-595, at 1–3 (1922); H.R. REP. NO. 67-248, at 1–2 (1921). Regarding the protective nature of the Fordney-McCumber Tariff Act of 1922, one commentator observed:

The Republican Party wanted to quickly reverse the low rates of the Underwood-Simmons Tariff of the Wilson administration. Protectionism had never died, but remained dormant during World War I, and now its supporters could base their arguments on both economics and nationalism. They claimed that the economic prosperity which occurred during the war was due mostly to a lack of imports and to the abundance of exports. Now that the war had ended, imports would increase, threatening the current economic prosperity. Why should Americans suffer economic hardship, especially after sending our boys to fight in a war that we did not start—a war that was supposed to make the world a better place, but now seemed a mistake? Isolationism—keeping out of international affairs, and worrying more about your own country—was on the rise in the United States, as the Senate, in the last days of the Wilson administration voted against joining the League of Nations. Isolationism, nationalism and the concern for continued prosperity made it easier for protectionists to press their arguments for a higher protective tariff. These trends led to the passage of Emergency Tariff in 1921 and to the Fordney-McCumber Tariff a year later. The rates of these tariffs rivaled the protectionist Payne-Aldrich Tariff of 1909, and were considerably higher than the Underwood-Simmons Tariff passed in 1913.

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passed as a “midnight amendment” after only ten minutes of debate.<sup>73</sup> Historically, section 526 was enacted with an eye toward protecting foreign trademarks (mostly German-owned trademarks and assets) confiscated by the United States during World War I.<sup>74</sup> Unfortunately, as the legislative record reveals, there was a rampant misunderstanding among congressmen concerning the holding and facts of *Katzel*.<sup>75</sup>

Section 526 was reenacted under the Smoot-Hawley Tariff Act of 1930. Some scholars insist that the Smoot-Hawley Tariff Act of 1930 was the most restrictive and protectionist tariff legislation passed in American history.<sup>76</sup>

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. . . In conclusion, nationalism and isolationism resulted from World War I, leading to a return of protectionism, with the passage of the Emergency Tariff in 1921 and Fordney McCumber Tariff in 1922. This in turn hurt both the domestic and international economies. Ironically, President Herbert Hoover stayed the course—by signing an even more protectionist tariff bill, the Smoot-Hawley Tariff of 1930. In the aftermath of the Great Depression and the collapse in world trade, the U.S. moved back toward free trade in 1933, when Democratic President Franklin D. Roosevelt and his Secretary of State Cordell Hull worked to end protectionism through a series of bilateral and later multilateral agreements, with foreign countries.

Edward S. Kaplan, N.Y. City Coll. of Tech. of CUNY, *The Fordney-McCumber Tariff of 1922*, <http://eh.net/encyclopedia/article/Kaplan.Fordney> (last visited July 4, 2010).

<sup>73</sup> See generally 61 CONG. REC. 3383, 3384 (1921) (statement of Rep. Garner) (“Mr. Speaker, I ask unanimous consent that the minority may have until 12 o’clock to-night to present their views and that their views may accompany and be printed with the majority report . . . It could not possibly interfere with tomorrow if we file our views by 12 o’clock to-night.”).

<sup>74</sup> See generally TIMOTHY H. HIEBERT, *PARALLEL IMPORTATION IN U.S. TRADEMARK LAW* 48–54 (1994).

The unusual willingness of Congress to take up an issue then pending before the Supreme Court highlights the matter’s substantial political importance. Transcending the dispute between Bourjois and *Katzel* was a more general concern over the fate of certain enemy assets which the United States had confiscated during the First World War. These had included many formerly German-owned enterprises located in the United States, which the United States’ Alien Property Custodian eventually sold, along with their trademarks and goodwill, to American citizens.

*Id.* at 48.

<sup>75</sup> See *id.* at 48–51.

<sup>76</sup> See, e.g., Tobias L. Millrood, Comment, *Third Party Intentional Interference with International Exclusive Dealing Contracts: An Alternative Solution to the Obstacles in Parallel Importation Litigation*, 1 TULSA J. COMP. & INT’L L. 359, 364 & n.28 (1994) (citing Steven P. Kersner & Donald S. Stein, *Judicial Construction of Section 526 and the Importation of Grey Market Goods: From Total Exclusion to Unimpeded Entry*, 11 N.C. J. INT’L L. & COM. REG. 251, 260 n.48 (1986)).



The language of section 526 appears to be plain and unequivocal: it is unlawful to import merchandise bearing the registered trademark of a U.S. citizen. In cases where the provisions of section 526 are violated, the goods are subject to seizure by the U.S. Customs Service and the violator is subject to money damages, obliteration of the trademark, and the costs of reexporting the goods.<sup>77</sup> The penalties appear to be harsh and severe for parallel importers. Section 526 has two remedies for the victims of parallel importation: first, through administrative and regulatory enforcement within the Customs Service and second, through judicial interpretation, construction, and manipulation of the statutory language.

## 2. *Customs Service Enforcement of Section 526*

### a. *Pre-1999 Customs Service Enforcement of Section 526*

Prior to February 1999, when new regulations were adopted and finalized, despite section 526's prohibition of the importation of trademarked goods, gray marketers found safe harbor under the loopholes created by administrative and regulatory enforcement on the part of the Customs Service.<sup>78</sup> Customs regulation 19 C.F.R. § 133.21 served as the primary mechanism through which section 526 was enforced. Within section 133.21(c), there were major exceptions to section 526, which allowed for gray market importation.<sup>79</sup>

Under the "same person" exception, trademarked merchandise may be imported into the United States if both the foreign and U.S. trademarks were owned by the same person or business entity.<sup>80</sup> Under the "common ownership or control" exception, trademarked merchandise may be imported into the United States where the domestic (American) and foreign trademarks are the property of "related companies."<sup>81</sup> The "common ownership or control" exception provides that where the "foreign and domestic trademark owners are parent and subsidiary companies or otherwise subject to . . . common control[,] the articles may be imported."<sup>82</sup> Previously,

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<sup>77</sup> 19 U.S.C. § 1526(b), (c), (e), (f) (2006).

<sup>78</sup> See 19 C.F.R. § 133.21 (1998) (amended in 1999); see also HIEBERT, *supra* note 74, at 74–79 (providing a concise and cogent discussion of Custom Service regulations under section 526).

<sup>79</sup> 19 C.F.R. § 133.21(c).

<sup>80</sup> 19 C.F.R. § 133.21(c)(1).

<sup>81</sup> *Id.*

<sup>82</sup> *Id.*

the “authorized use” exception permitted the importation of articles bearing a trademark authorized by the U.S. trademark holder.<sup>83</sup> Finally, the “written consent” exception allowed for gray market importation where the trademark owner gave written consent for the importation of gray market articles.<sup>84</sup> Prior to 1999, as far as trademark law is concerned, the Customs Service interpretation and enforcement of section 526 had been the flashpoint in the battle to exclude parallel imports. Over the years, a number of litigants have brought actions seeking to clarify the interpretation and enforcement of section 526.<sup>85</sup> Virtually all litigants have been unsuccessful.<sup>86</sup>

*b. Post-1999 Customs Service Enforcement of Section 526: The Lever Brothers Rule*

On February 24, 1999, the Customs Service issued final rules that amended 19 C.F.R. section 133.<sup>87</sup> The new regulations restricted the importation, in specific circumstances, of gray market goods that are “physically and materially different” from trademarked goods and items authorized for sale by a U.S. trademark owner.<sup>88</sup> The new regulations became effective on March 26, 1999.<sup>89</sup> The new regulations are known as the *Lever Brothers* rules or collectively as *Lever-rule* protection<sup>90</sup> because they are rooted in the famous 1993 *Lever Brothers Corp. v. United States* case.<sup>91</sup>

The *Lever* rule contains guidelines for determining whether gray market goods produced by a company affiliated with a U.S. trademark owner are “restricted gray market articles”<sup>92</sup> or “restricted gray

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<sup>83</sup> 19 C.F.R. § 133.21(c)(3).

<sup>84</sup> *Id.* § 133.21(c)(6).

<sup>85</sup> *See generally infra* Part II.D.3 (discussing and analyzing major cases seeking clarity with regard to the interpretation and enforcement of 19 C.F.R. § 133.21 (1998)).

<sup>86</sup> *See* Part II.D.3.

<sup>87</sup> *See generally* 64 Fed. Reg. 9058 (Feb. 24, 1999) (codified at 19 C.F.R. § 133.21).

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *See generally* 19 C.F.R. § 133.2(e)(3) (2009) (citing *Lever Bros. Co. v. United States*, 981 F.2d 1330 (D.C. Cir. 1993)).

<sup>91</sup> *Lever Bros. Co. v. United States*, 981 F.2d 1330 (D.C. Cir. 1993).

<sup>92</sup> 19 C.F.R. § 133.23(a). A “restricted gray market article” is a “foreign-made [article] bearing a genuine trademark or trade name identical with or substantially indistinguishable from one owned and recorded by a citizen of the United States or a corporation or association created or organized within the United States and imported without the authorization of the U.S. owner.” *Id.*

market goods,”<sup>93</sup> and thereby eligible for seizure.<sup>94</sup> At a baseline, the “restricted gray market articles” must possess a “physical and material difference.”<sup>95</sup> This is known as the “physical and material difference” standard.<sup>96</sup> The Customs Service uses a nonexclusive list of five categories or guidelines to determine whether goods are “physically and materially different.”<sup>97</sup> These five categories include the following:

- (1) The specific composition of both the authorized and gray market product(s) (including chemical composition);
- (2) Formulation, product construction, structure, or composite product components, of both the authorized and gray market product;
- (3) Performance [and] . . . operational characteristics of both the authorized and gray market product;
- (4) Differences resulting from legal or regulatory requirements, certification, etc.;
- (5) Other distinguishing and explicitly defined factors that would likely result in consumer deception or confusion as proscribed under applicable law.<sup>98</sup>

U.S. trademark owners must demonstrate with “particularity” that one or more of these five categories of physical or material differences exists.<sup>99</sup> In order to receive *Lever*-rule protection, owners are required to provide “competent evidence” to the Customs Service

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<sup>93</sup> *See id.* “Restricted gray market goods” are goods that bear

a genuine trademark or trade name which is: (1) . . . [a]ppplied by a licensee (including a manufacturer) independent of the U.S. owner[;] or (2) . . . [a]ppplied under the authority of a foreign trademark or trade name owner other than the U.S. owner, a parent or subsidiary of the U.S. owner, or a party otherwise subject to common ownership or control with the U.S. owner . . . , from whom the U.S. owner acquired the domestic title, or to whom the U.S. owner sold the foreign title(s); or (3) . . . [a]ppplied by the U.S. owner, a parent or subsidiary of the U.S. owner, or a party otherwise subject to common ownership or control with the U.S. owner . . . , to goods that the Customs Service has determined to be physically and materially different [under the *Lever*-rule] from the articles authorized by the U.S. trademark owner for importation or sale in the U.S.

*Id.*

<sup>94</sup> *See generally* 19 C.F.R. §§ 133.2(e), 133.23(a), (e) (2009).

<sup>95</sup> *Id.* § 133.2(e).

<sup>96</sup> *Id.*

<sup>97</sup> *See id.* § 133.2(e)(1)–(5).

<sup>98</sup> *Id.*

<sup>99</sup> *Id.* § 133.2(e).

that one or more of the five categories of physical or material differences outlined above exists.<sup>100</sup> A U.S. trademark owner must submit a request to receive *Lever*-rule protection.<sup>101</sup> The Customs Service publishes a list of products subject to *Lever*-rule protection, along with a list of physical and material differences, in the *Customs Bulletin*.<sup>102</sup> If *Lever*-rule protection is granted, the Customs Service then publishes a notice in the *Customs Bulletin* that a trademark has received protection with regard to a specific product.<sup>103</sup> Goods granted *Lever*-rule protection are denied entry and are subject to detention.<sup>104</sup>

Where “physical and material differences” exist among goods and *Lever*-rule protection is granted, denial of entry and detention will *not* occur if the goods bear

a conspicuous and legible label designed to remain on the product until the first point of sale to a retail consumer in the United States stating that: “This product is not a product authorized by the United States trademark owner for importation and is physically and materially different from the authorized product.” The label must be in close proximity to the trademark as it appears in its most prominent location on the article itself or the retail package or container. [Additionally,] [o]ther information designed to dispel consumer confusion may also be added.<sup>105</sup>

As the Customs Service has articulated, labeling of “physically and materially different” goods offers consumer protection and greater product differentiation.<sup>106</sup> After denial of entry and detention, the importer has the burden of proof to show that the goods are identical, or that an exception applies, or where “physically and materially different” goods subject to *Lever*-rule protection are involved, the importer may simply choose to add a cautionary label like the one described above and obtain release of the goods.<sup>107</sup>

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<sup>100</sup> *Id.*

<sup>101</sup> *Id.*

<sup>102</sup> *Id.* § 133.2(f).

<sup>103</sup> *Id.*

<sup>104</sup> *Id.* § 133.25.

<sup>105</sup> *Id.* § 133.23(b).

<sup>106</sup> See *supra* text accompanying notes 95–97.

<sup>107</sup> 19 C.F.R. § 133.23(d).

### 3. *Judicial Interpretations of Section 526*

#### a. *Vivitar Corp. v. United States*

In *Vivitar v. United States*, Vivitar Corporation, a California-based manufacturer of photographic equipment, brought an action in the Court of International Trade seeking a declaratory judgment invalidating the Customs Service's interpretation of section 526 and regulation (under 19 C.F.R. § 133.21) allowing importation of any gray market goods.<sup>108</sup> On cross-motions for summary judgment, the Court of International Trade ruled in the government's favor, upholding the Customs Service interpretation of section 526 under the regulations promulgated at section 133.21.<sup>109</sup> Vivitar appealed this decision to the U.S. Court of Appeals for the Federal Circuit.

The facts demonstrated that Vivitar had "little or no manufacturing facilities of its own, but rather . . . its products [were] manufactured to specification by various foreign manufacturers, principally in Japan."<sup>110</sup> Vivitar had its U.S. trademark "VIVITAR" displayed or affixed on its equipment.<sup>111</sup> Vivitar established an extensive worldwide marketing and distribution system whereby Vivitar retained the U.S. market, and various foreign subsidiary corporations controlled marketing and distribution abroad.<sup>112</sup> In the United States, Vivitar set up a channel of independent, authorized dealerships that resold Vivitar products to the public.<sup>113</sup> Vivitar maintained price differentials between its U.S. and foreign markets.<sup>114</sup> As a result, this price differential made it profitable for discounters to import Vivitar equipment from foreign markets to the United States.<sup>115</sup> As the court noted: "Vivitar seeks to justify its authorized dealers' higher prices as compared to those of discount houses by its extensive advertising costs, warranty costs, and other legitimate business expenses

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<sup>108</sup> The decisions of the Court of International Trade on jurisdiction and the merits of *Vivitar Corp. v. United States* are reported at 7 Ct. Int'l Trade 170 (1984) and 8 Ct. Int'l Trade 109 (1984).

<sup>109</sup> *Vivitar*, 8 Ct. Int'l Trade 109.

<sup>110</sup> *Vivitar Corp. v. United States*, 761 F.2d 1552, 1556 (Fed. Cir. 1985).

<sup>111</sup> *Id.*

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

necessary to promote its VIVITAR products in the U.S. and maintain its goodwill in the mark.”<sup>116</sup>

Since no trial was conducted, Vivitar did not challenge any specific import transaction in asserting that the Customs Service regulation of section 1526 was unreasonable.<sup>117</sup> Ultimately, the Court of Appeals held that 19 C.F.R. § 133.21 was “a reasonable exercise of Customs’ power to exclude under the statute as a matter of agency initiated enforcement.”<sup>118</sup> In holding that the Customs Service is not required to exclude all gray market goods under section 526, the court noted: “Congress could not have foreseen all possibilities in international trade relationships at the time of enacting the statute. The variations of the grey market are myriad.”<sup>119</sup> The court concluded its examination of section 526—and the regulation under 19 C.F.R. § 133.21—by stating:

Where protection under the statute is unclear or depends upon resolution of complex factual situations, Customs may decline to impose *sua sponte* the extreme sanction of exclusion and leave such cases for initial determination by the district courts under the private remedies provided to the trademark owner in § 1526(c).<sup>120</sup>

In the future, this is exactly what other litigants would do.

*b. Olympus Corp. v. United States*

In *Olympus Corp. v. United States*, Olympus Corporation (Olympus), a New York-based, wholly owned subsidiary of Olympus Optical Co., a Japanese photographic company, brought an action for declaratory and injunctive relief to determine the validity of the Customs Service regulation under section 526.<sup>121</sup> Thwarting Olympus’s efforts to eradicate gray market importation, the district court held that the Customs Service regulation and interpretation of section 526 was valid.<sup>122</sup>

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<sup>116</sup> *Id.*

<sup>117</sup> *See id.*

<sup>118</sup> *Id.* at 1555 (“Since the factual situations involving grey market importations vary widely and not all may be in violation of § 1526(a), we hold that Customs is not required to provide for automatic exclusion beyond that set forth in its current regulations.”).

<sup>119</sup> *Id.* at 1569–70.

<sup>120</sup> *Id.* at 1570.

<sup>121</sup> *Olympus Corp. v. United States*, 792 F.2d 315, 316 (2d Cir. 1986).

<sup>122</sup> *Id.*

On appeal, holding that the “Customs regulation is valid,”<sup>123</sup> the Second Circuit reasoned that the “regulations have . . . been sufficiently consistent to warrant a finding that longstanding administrative interpretation confirms . . . [the Government’s] reading of the statute.”<sup>124</sup> The court went on to add “[w]hile [it] find[s] the regulation of questionable wisdom . . . congressional acquiescence in the longstanding administrative interpretation of the statute legitimates that interpretation as an exercise of Customs’ enforcement discretion.”<sup>125</sup> The Second Circuit was quick to point out that although the Customs Service regulation was valid, the regulations did not limit the reach of protection under section 526: the trademark holder still has rights under section 526, namely private remedies under section 526(c) to exclude goods.<sup>126</sup>

c. *Coalition to Preserve the Integrity of American Trademarks v. United States*

In *Coalition to Preserve the Integrity of American Trademarks v. United States (COPIAT)*, the Coalition to Preserve the Integrity of American Trademarks, a trade association consisting of American companies holding U.S. trademarks, plus two of its members, Cattier, Inc., and Charles of the Ritz Group Ltd., brought yet another action challenging the validity of the Customs Service regulation of section 526 of the Tariff Act of 1930 and section 42 of the Lanham Trademark Act of 1946.<sup>127</sup>

At the district court level, consistent with prior precedent, on cross-motions for summary judgment and a motion to dismiss, the district court upheld the Customs Service regulations, holding that they were a “sufficiently reasonable” interpretation of the governing statutes.<sup>128</sup> Further, the court observed that section 133.21 was “supported by the legislative history, judicial decisions, legislative acquiescence, and the long-standing consistent policy of the Customs Service.”<sup>129</sup> The

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<sup>123</sup> *Id.*

<sup>124</sup> *Id.* at 319.

<sup>125</sup> *Id.* at 320.

<sup>126</sup> *Id.*

<sup>127</sup> See *Coal. to Pres. the Integrity of Am. Trademarks v. United States*, 598 F. Supp. 844, 846–47 (D.D.C. 1984); 15 U.S.C. § 1124 (2006).

<sup>128</sup> *Coal. to Pres. the Integrity of Am. Trademarks*, 598 F. Supp. at 852.

<sup>129</sup> *Id.*

district court's view on the validity of the Customs regulations was in accord with those expressed by other courts.<sup>130</sup>

The *COPIAT* case started out at a mundane pitch in the district court: there, the court merely followed precedent. The tectonic shift took place at the circuit court level, where the U.S. Court of Appeals for the D.C. Circuit heard the case on appeal. Judge Silberman, writing for the court, held that "the [section 133.21] regulations simply cannot be squared with Section 526 and are thus invalid."<sup>131</sup> The court did not reach whether the regulations were consistent with section 42 of the Lanham Act.<sup>132</sup> The court reasoned that based on a plain language reading of section 526, *all* parallel importation was prohibited; facially and linguistically, no exceptions were provided for in the statute, thus, allowing Customs Service exceptions ran counter to the statutory language and intent. The court expressed this opinion when it wrote: "Section 526 does not, on its face, admit of any exceptions based upon the relationship of the American and foreign trademark owners or upon whether the American owner has authorized the use of the trademark abroad."<sup>133</sup> The court entered into an extensive examination of the legislative history and intent behind section 526 to buttress its position.<sup>134</sup> For the court, this examination revealed that Congress's intent in enacting section 526 was the unequivocal prohibition of all parallel importation. Thus, "that is the end of the matter."<sup>135</sup>

From its review, the *COPIAT* court found that "the Customs Service's interpretation of Section 526 does not display the necessary 'thoroughness, validity, and consistency' to merit judicial acceptance."<sup>136</sup> The court placed great reliance in reaching its decision on the fact that section 133.21 had not been adopted

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<sup>130</sup> See, e.g., *Olympus Corp. v. United States*, 792 F.2d 315 (2d Cir. 1986); *Vivitar Corp. v. United States*, 761 F.2d 1552 (Fed. Cir. 1985); *Parfums Stern, Inc. v. U.S. Customs Serv.*, 575 F. Supp. 416 (S.D. Fla. 1983).

<sup>131</sup> *Coal. to Pres. the Integrity of Am. Trademarks v. United States*, 790 F.2d 903, 907 (D.C. Cir. 1986).

<sup>132</sup> *Id.* ("In light of this holding, it is unnecessary to decide whether the regulations would be consistent with Section 42 standing alone.")

<sup>133</sup> *Id.* at 907-08.

<sup>134</sup> *Id.* at 908-16.

<sup>135</sup> *Id.* at 908 (quoting *Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc.*, 467 U.S. 837, 843 (1984)).

<sup>136</sup> *Id.* at 916 (quoting *Fed. Election Comm'n v. Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 37 (1981)).



contemporaneously with section 526.<sup>137</sup> Moreover, the Customs Service in the court's view showed poor articulation, vacillation, and unclear reasoning both in adopting section 133.21 and in its regulatory enforcement.<sup>138</sup> Finally, having reached the conclusion that the regulation was invalid, the court remanded the case to the district court with instructions to issue a declaratory judgment holding section 133.21(c)(1)–(3) unlawful.<sup>139</sup>

*COPIAT* caused a split of authority among the circuits. *Olympus* and *Vivitar* in effect endorsed gray market goods by upholding the Customs Service regulation. *COPIAT* had the opposite effect by invalidating the Customs Service regulation and holding that section 526 categorically denied entry of *all* parallel imports. By creating this split, *COPIAT* stirred the waves so much that Supreme Court intervention in the gray market debate became inevitable.

d. *K Mart Corp. v. Cartier, Inc.*

In *K Mart Corp. v. Cartier, Inc.*, on a consolidated appeal and hearing, the Supreme Court rehashed the issues brought up on appeal in *COPIAT*, namely whether the Customs Service's regulation, section 133.21(c)(1)–(3), was a valid administrative interpretation of § 526.<sup>140</sup> The Supreme Court granted certiorari to “resolve a conflict among the Courts of Appeals.”<sup>141</sup> Since the *COPIAT* court did not reach section 42 of the Lanham Act, neither did the Supreme Court on review.<sup>142</sup> The Court was charged with determining the validity of three provisions of 19 C.F.R. § 133.21(c). A majority of the Court

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<sup>137</sup> *Id.*

<sup>138</sup> *Id.* at 916–17.

[T]he first set of Customs regulations announcing this policy appeared to implement *another* statute, then-Section 27 of the Trade-Mark Act of 1905, rather than Section 526. Nor has the Customs Service's interpretation since that time been supported by anything more than poorly articulated and vacillating reasoning. . . . At least since the 1950s, Customs' interpretation has been driven in large part by a perceived need to obviate the antitrust problems raised by a multinational corporation's use of an American subsidiary to preclude competition in the distribution of its trademarked product.

*Id.* (citation omitted).

<sup>139</sup> *Id.* at 918.

<sup>140</sup> *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281, 290 (1988).

<sup>141</sup> *Id.*

<sup>142</sup> *Id.* at 290 n.3 (“[A]lso asserted that the Customs Service regulation was inconsistent with § 42 of the Lanham Trade-Mark Act . . . . That issue is not before us.” (citation omitted)).

held that the common-control exception under subsections 133.21(c)(1)–(2) was consistent with section 526.<sup>143</sup> In the Court’s view, subsections 133.21(c)(1)–(2) were “permissible constructions designed to resolve statutory ambiguities.”<sup>144</sup>

However, a different majority held that the authorized-use exception, subsection § 133.21(c)(3), was inconsistent with section 526. The Court held that the “authorized-use” exception was invalid because: “[T]he regulation denies a domestic trademark holder the power to prohibit the importation of goods made by an independent foreign manufacturer where the domestic trademark holder has authorized the foreign manufacturer to use the trademark.”<sup>145</sup> Further, “[u]nder no reasonable construction of the statutory language can goods made in a foreign country by an independent foreign manufacturer be removed from the purview of the statute.”<sup>146</sup> For these reasons, the Court held section 133.21(c)(3) was in “conflict with the unequivocal language of the statute” and severable from the rest of the regulation.<sup>147</sup>

#### *E. Sections 32 and 42 of the Lanham Act*

Over the years, registered U.S. trademark holders have attempted to have gray market goods excluded under sections 32 and 42 of the Lanham Trademark Act of 1946. Pursuant to section 32 of the Act, the U.S. holder of a registered trademark may proceed to exclude any “reproduction, counterfeit, copy, or colorable imitation” of their mark, imported without their consent, that is “likely to cause confusion, or to cause mistake, or to deceive.”<sup>148</sup> Further, section 42 prohibits the importation of any article of merchandise that “copies” or “simulates” a registered U.S. trademark.<sup>149</sup>

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<sup>143</sup> *Id.* at 291.

<sup>144</sup> *Id.* at 292.

<sup>145</sup> *Id.* at 294.

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> 15 U.S.C. § 1114(1)(a) (2006).

<sup>149</sup> § 1124. This section provides, in pertinent part:

Except as provided in subsection (d) of section 1526 . . . no article of imported merchandise which shall copy or simulate the name of any domestic manufacture, or manufacturer, or trader, or of any manufacturer or trader located in any foreign country which, by treaty, convention, or law affords similar privileges to citizens of the United States, or which shall copy or simulate a trademark registered in accordance with the provisions of this chapter or shall bear a name or mark calculated to induce the public to believe that the article is

### 1. *Administrative Interpretations of Section 42 of the Lanham Act*

Most important, section 42 of the Lanham Act falls under the same regulatory authority as section 526. Thus, under the authority of Customs Service regulation section 133.21(c), the same exceptions that allow for the importation of gray market goods under section 526 apply to section 42 as well. In terms of litigation, registered U.S. trademark holders trying to attack gray market goods in court under section 42 have largely failed, just as they have under section 526.

### 2. *Judicial Interpretations of Sections 32 and 42 of the Lanham Act*

#### a. *Monte Carlo Shirt, Inc. v. Daewoo International Corp.*

Monte Carlo Shirt, Inc. (Monte Carlo), a New York corporation, entered into a contract with Daewoo Industrial Company, Ltd. (Daewoo), a South Korean corporation, to buy nearly three thousand “men’s dress shirts manufactured to its specifications and bearing its label[s].”<sup>150</sup> When the shirts arrived in America, Monte Carlo rejected them because they had arrived too late to be sold during Christmas.<sup>151</sup> Subsequently, Daewoo’s American subsidiary, Daewoo International (American) Corp. (Daewoo America), bought the shirts from Daewoo.<sup>152</sup> Daewoo America began selling the shirts to discount retailers, bearing Monte Carlo’s labels and plastic bags, without Monte Carlo’s permission.<sup>153</sup> “Monte Carlo sued Daewoo . . . for breach of contract, common-law trademark and tradename infringement, [tortious] interference with [a] business [relationship], conversion, violation of a provision of the California Unfair Practices Act . . . and violation of the Lanham Act, 15 U.S.C. §§ 1051–1127.”<sup>154</sup> Daewoo entered a cross-complaint for breach of contract.<sup>155</sup>

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manufactured in the United States, or that it is manufactured in any foreign country or locality other than the country or locality in which it is in fact manufactured, shall be admitted to entry at any customhouse of the United States  
. . . .

<sup>150</sup> *Monte Carlo Shirt, Inc. v. Daewoo Int’l (Am.) Corp.*, 707 F.2d 1054, 1055 (9th Cir. 1983).

<sup>151</sup> *Id.*

<sup>152</sup> *Id.*

<sup>153</sup> *Id.* at 1055–56.

<sup>154</sup> *Id.* at 1056 (footnote omitted) (citation omitted).

<sup>155</sup> *Id.*

At trial, “the jury entered a verdict for Monte Carlo on the breach of contract claim,” awarding \$79,073 for lost profits.<sup>156</sup> On the trademark claim, the jury awarded Monte Carlo \$1,582,735 in general compensatory damages, \$70,048 in special compensatory damages, and \$3,000,000 in punitive damages.<sup>157</sup> On the Lanham Act claim, the court directed a verdict for Daewoo; Daewoo moved for a new trial or judgment notwithstanding the verdict.<sup>158</sup> The court granted a new trial on the trademark infringement claims, and before the new trial, Daewoo won a motion for summary judgment.<sup>159</sup> The district court held that “[t]he sale of the Monte Carlo shirts with the Monte Carlo labels intact could not as a matter of law deceive or confuse the public concerning the source and origin of the shirts.”<sup>160</sup>

On appeal, the question before the court “was whether an action would lie in trademark for Daewoo’s unauthorized sale of genuine Monte Carlo shirts.”<sup>161</sup> The court noted that “[a] showing of likely buyer confusion as to the source, origin, or sponsorship of goods is part of a cause of action for infringement of a registered trademark.”<sup>162</sup> On the Lanham Act claim, the court held there was no confusion as the goods were genuine and observed:

The goods sold by Daewoo were not imitations of Monte Carlo shirts; they were the genuine product, planned and sponsored by Monte Carlo and produced for it on contract for future sale. The shirts were not altered or changed from the date of their manufacture to the date of their sale. . . . Their source was Monte Carlo; the absence of Monte Carlo’s<sup>163</sup> authorization of the discount retailers to sell does not alter this.

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<sup>156</sup> *Id.*

<sup>157</sup> *Id.*

<sup>158</sup> *Id.*

<sup>159</sup> *Id.*

<sup>160</sup> *Id.* (alteration in original).

<sup>161</sup> *Id.* at 1057.

<sup>162</sup> *Id.* at 1058 (citing *Carson Mfg. Co. v. Carsonite Int’l Corp.*, 686 F.2d 665, 669–70 (9th Cir. 1981), *cert. denied*, 460 U.S. 1052 (1983); *Levi Strauss & Co. v. Blue Bell, Inc.*, 632 F.2d 817, 821–22 (9th Cir. 1980); *Lindy Pen Co. v. Bic Pen Corp.*, 550 F. Supp. 1056, 1060–61 (C.D. Cal. 1982)).

<sup>163</sup> *Id.* (footnote omitted).

b. *Bell & Howell: Mamiya Co. v. Masel Supply Co.*

In *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, Masel Supply Co. appealed an injunction order forbidding it from distributing photographic products bearing the trademark Bell & Howell.<sup>164</sup>

Bell & Howell was the registered owner of three trademarks bearing the Mamiya label.<sup>165</sup> Mamiya Camera Co. (Mamiya Camera), a Japanese corporation, manufactured photographic equipment in Japan.<sup>166</sup> Mamiya Camera sold the equipment to an exclusive worldwide distributor, J. Osawa & Co. Ltd. (Osawa & Co.), a Japanese corporation.<sup>167</sup> Bell & Howell distributed, marketed, and sold the equipment in the United States.<sup>168</sup> Ninety-three percent of Bell & Howell stock was owned by Osawa USA, a New York corporation wholly owned by Osawa & Co., the Japanese corporation.<sup>169</sup> Bell & Howell's packaging, warranty, and price policies were controlled by Osawa & Co.<sup>170</sup>

In 1980, Bell & Howell spent more than \$5 million to promote and advertise Mamiya products locally and nationally in the United States.<sup>171</sup> Masel, a New York-based camera wholesaler, began purchasing and importing Mamiya cameras from an international dealer in Hong Kong that purchased them from Osawa & Co.<sup>172</sup> Bell & Howell alleged that Masel's cameras confused consumers because they came without warranties, and that Masel's cameras sold in competition with Bell & Howell's cameras infringed Bell & Howell's trademark and goodwill.<sup>173</sup>

In vacating the district court's grant of preliminary injunction, the Second Circuit ruled that Bell & Howell could show no irreparable injury "since the consumer can be made aware by, among other things, labels on the camera boxes or notices in advertisements as to whether the cameras are sold with or without warranties."<sup>174</sup> On the

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<sup>164</sup> *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 719 F.2d 42, 43 (2d Cir. 1983).

<sup>165</sup> *Id.*

<sup>166</sup> *Id.*

<sup>167</sup> *Id.*

<sup>168</sup> *Id.*

<sup>169</sup> *Id.* at 44.

<sup>170</sup> *Id.*

<sup>171</sup> *Id.* at 43.

<sup>172</sup> *Id.*

<sup>173</sup> *See id.* at 43–44.

<sup>174</sup> *Id.* at 46.

facts, the court noted that Bell & Howell failed to show that consumers would be misled about their camera purchases with Masel's camera equipment on the market.<sup>175</sup> Other courts have reached similar results.<sup>176</sup>

c. *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*

In *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, the makers of Cabbage Patch Kids brought an action to enjoin the importation of trademarked goods manufactured in Spain.<sup>177</sup> Original Appalachian Artworks, Inc. (OAA), sold its dolls in the United States through "adoption centers" located primarily in specialty stores and fine department stores.<sup>178</sup> Purchasers of Cabbage Patch Dolls received "birth certificates" and "adoption papers," which were to be filled out by the "parent" of the doll who, in turn, takes an "oath of adoption."<sup>179</sup> The adoption papers were registered in a computer by OAA, and on the Cabbage Patch Kid's first birthday, it received a "birthday card."<sup>180</sup> This elaborate marketing system established by OAA constituted an "important element of the mystique of the [Cabbage Patch Kids] dolls, which has substantially contributed to their enormous popularity and commercial success."<sup>181</sup>

OAA, the registered U.S. trademark owner of Cabbage Patch Kids, entered into a territorially restrictive license agreement with Jesmar, a Spanish manufacturer, to produce and distribute Cabbage Patch Kids

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<sup>175</sup> *Id.*

<sup>176</sup> See, e.g., *NEC Elecs. v. CAL Circuit Abco*, 810 F.2d 1506, 1510 (9th Cir. 1987). In *NEC Electronics*, a chip manufacturer sued a gray market importer under section 32 of the Lanham Act, applying a rationale similar to that applied under section 42 in *Olympus*, and the court noted:

[T]he *Olympus* court concluded that section 42 of the Lanham Act . . . barring importation of goods that 'copy or simulate' a trademark, did not apply to genuine goods except in cases presenting the same 'equities' as *Katzel*. . . . [Thus,] [w]here the American trademark owner is a wholly-owned and controlled subsidiary of the foreign manufacturer, neither of the *Katzel* rationales applies."

*Id.* (citations omitted).

<sup>177</sup> *Original Appalachian Artworks, Inc. v. Granada Elecs., Inc.*, 816 F.2d 68, 70 (2d Cir. 1987).

<sup>178</sup> *Id.*

<sup>179</sup> *Id.*

<sup>180</sup> *Id.*

<sup>181</sup> *Id.* (alteration in original) (quoting *Original Appalachian Artworks, Inc. v. Granada Elecs., Inc.*, 640 F. Supp. 928, 930 (S.D.N.Y. 1986)).

(the “Spanish Kids”) primarily in Spain.<sup>182</sup> Under the licensing agreement, “Jesmar agreed not to make, sell, or authorize any sale of the [Spanish Kids] outside its licensed territory and to sell only to those purchasers who would agree not to use or resell the [Spanish Kids] outside the licensed territory.”<sup>183</sup> Jesmar’s Spanish Kids, although bearing the U.S. trademark, differed from Cabbage Patch Kids because their “adoption papers” were in Spanish.<sup>184</sup>

Granada Electronics, Inc. (Granada), imported the Spanish Kids into the United States, directly competing with OAA.<sup>185</sup> OAA brought suit under section 32 of the Lanham Act to enjoin Granada’s importation of Spanish Kids. Affirming the district court’s injunction, the Second Circuit concluded that “Jesmar’s dolls were not intended to be sold in the United States and, most importantly, were materially different from . . . Cabbage Patch Kids dolls sold in the United States.”<sup>186</sup> The Second Circuit enjoined importation of the Spanish Kids by Granada, reasoning the goods were not “genuine” because they “differ from the [American] dolls and were not authorized for sale in the United States.”<sup>187</sup>

The court held that under section 32 of the Lanham Act consumer confusion could be shown.<sup>188</sup> The court noted:

There is a very real difference in the product itself—the foreign language adoption papers and birth certificate, coupled with the United States fulfillment houses’ inability or unwillingness to process Jesmar’s adoption papers or mail adoption certificates and birthday cards to Jesmar doll owners, and the concomitant inability of consumers to “adopt” the dolls.<sup>189</sup>

Thus, “this difference . . . creates the confusion over the source of the product and results in a loss of OAA’s . . . good will.”<sup>190</sup>

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<sup>182</sup> *Id.*

<sup>183</sup> *Id.*

<sup>184</sup> *Id.*

<sup>185</sup> *Id.*

<sup>186</sup> *Id.* at 73.

<sup>187</sup> *Id.*

<sup>188</sup> *Id.*

<sup>189</sup> *Id.*

<sup>190</sup> *Id.*

*F. Section 337*

According to the terms of section 337(a) of the Tariff Act of 1930,<sup>191</sup> the International Trade Commission (ITC) can sanction “unlawful activities” that constitute “unfair acts in . . . importation.”<sup>192</sup> Section 337(b) provides the ITC with the authority to investigate “alleged violation[s]” that constitute “unfair practices” in trade.<sup>193</sup> Under section 337(d), when the ITC determines that a violation of section 337 has occurred, the ITC may exclude the “articles concerned . . . from entry into the United States.”<sup>194</sup> Finally, once the ITC determines that a violation of section 337 has occurred, the ITC must transmit a copy of its determination to the President; the President has the discretion to disapprove of the determination before the end of sixty days, overturning the determination for “policy

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<sup>191</sup> 19 U.S.C. § 1337 (2006). This section provides, in pertinent part:

(a) Unlawful activities; covered industries; definitions

(1) Subject to paragraph (2), the following are unlawful, and when found by the Commission to exist shall be dealt with, in addition to any other provision of law, as provided in this section:

....

(B) The importation into the United States, the sale for importation, or the sale within the United States after importation by the owner, importer, or consignee, of articles that—

(i) infringe a valid and enforceable . . . United States copyright registered under Title 17 . . .

....

(C) The importation into the United States, the sale for importation, or the sale within the United States after importation by the owner, importer, or consignee, of articles that infringe a valid and enforceable United States trademark registered under the Trademark Act of 1946 . . .

(2) Subparagraphs (B), (C) . . . of paragraph (1) apply only if an industry in the United States, relating to the articles protected by the patent, copyright, trademark, or mask work concerned, exists or is in the process of being established.

<sup>192</sup> 19 U.S.C. § 1337(a)(1)(A).

<sup>193</sup> 19 U.S.C. § 1337(b)(1).

<sup>194</sup> 19 U.S.C. § 1337(d)(1); *see, e.g., Bourdeau Bros., Inc. v. Int’l Trade Comm’n*, 444 F.3d 1317, 1323 (Fed. Cir. 2006) (“Thus, gray market law is not concerned with where the good was manufactured, nor is it concerned with whether the trademark owner controlled the manufacture of the product or authorized the use of the trademark on that product in another country. Instead, gray market law is concerned with whether the trademark owner has authorized use of the trademark on that particular product in the United States and thus whether the trademark owner has control over the specific characteristics associated with the trademark in the United States.”).



reasons.”<sup>195</sup> Section 337 serves as yet another statutory mechanism through which domestic trademark and copyright holders have tried to uphold their intellectual property rights. For the most part, section 337 has proved to be an effective remedy for U.S. industries.<sup>196</sup> However, jurisprudentially, the single most important case concerning gray market importation turned out in favor of parallel importers.

Duracell, the large battery manufacturer, brought the gray market importation of its batteries from Belgium to the attention of the ITC. On November 5, 1984, the ITC determined that the importation of Duracell batteries on the gray market was a violation of section 337 causing substantial injury to Duracell.<sup>197</sup> On January 4, 1985, within sixty days of receiving the ITC’s determination, President Ronald Reagan disapproved the ITC’s determination.<sup>198</sup> Duracell appealed the President’s disapproval to the U.S. Court of Appeals for the Federal Circuit, in *Duracell, Inc. v. U.S. International Trade Commission*.<sup>199</sup> Duracell called on the court to determine “whether the President’s disapproval was *for policy reasons*, as required by the statute.”<sup>200</sup> The court did not reach this question. On more technical legal grounds, the court dismissed Duracell’s appeal for lack of jurisdiction.<sup>201</sup> At first glance, the ITC was prepared to take a strong stance against parallel importation.<sup>202</sup> However, President Reagan cited departmental review of the issue of parallel importation and the formulation of a “cohesive policy” as policy reasons for his disapproval of the ITC’s determination.<sup>203</sup>

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<sup>195</sup> 19 U.S.C. § 1337(j)(2).

<sup>196</sup> See generally RALPH H. FOLSOM ET AL., INTERNATIONAL BUSINESS TRANSACTIONS: A PROBLEM-ORIENTED COURSEBOOK 800–03 (3d ed. 1995).

<sup>197</sup> *Duracell, Inc. v. U.S. Int’l Trade Comm’n*, 778 F.2d 1578, 1579–80 (Fed. Cir. 1985) (citing *In re Certain Alkaline Batteries*, 6 I.T.R.D. (BNA) 1849 (1984)).

<sup>198</sup> *Id.* at 1580.

<sup>199</sup> *Id.*

<sup>200</sup> *Id.*

<sup>201</sup> *Id.* at 1580–82.

<sup>202</sup> See *id.*

<sup>203</sup> *Id.* at 1581.

## III

## GRAY MARKETS AND COPYRIGHTED GOODS

A. *Copyrighted Goods: The Copyright Act of 1976*

In similar fashion to U.S. patent law, “federal copyright law owes its existence to Article 1, Section 8, Clause 8 of the [U.S.] Constitution.”<sup>204</sup> Clause 8 “permits Congress to secure to inventors for limited times the exclusive right to their discoveries, and to ‘authors’ the exclusive right to their ‘writings.’”<sup>205</sup> “Analogous to the patent law, the principal purpose of the copyright law is to recognize and protect the rights of ‘authors’ in their intellectual works and thus supply the incentive for the creation and dissemination of such works.”<sup>206</sup> Copyright holders are given the right to enjoin infringement if their work is copied. “Copyright law is essentially a system of property.”<sup>207</sup> Under section 106 of the Copyright Act, the holder of a copyright has the exclusive right to reproduce, distribute, perform, display, publish, and adapt the copyrighted work.<sup>208</sup> Those “exclusive rights” are subject to several exceptions, embodied in sections 107 through 122 of the Act. The right to distribute

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<sup>204</sup> EARL W. KINTNER & JACK LAHR, AN INTELLECTUAL PROPERTY LAW PRIMER 339 (2d ed. 1982).

<sup>205</sup> *Id.*

<sup>206</sup> *Id.*

<sup>207</sup> WILLIAM S. STRONG, THE COPYRIGHT BOOK: A PRACTICAL GUIDE 1 (4th ed. 1993).

<sup>208</sup> 17 U.S.C. § 106 (2006). This section reads, in pertinent part:

Subject to sections 107 through 122, the owner of copyright under this title has the exclusive rights to do and to authorize any of the following:

- (1) to reproduce the copyrighted work in copies or phonorecords;
- (2) to prepare derivative works based upon the copyrighted work;
- (3) to distribute copies or phonorecords of the copyrighted work to the public by sale or other transfer of ownership, or by rental, lease, or lending;
- (4) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and motion pictures and other audiovisual works, to perform the copyrighted work publicly;
- (5) in the case of literary, musical, dramatic, and choreographic works, pantomimes, and pictorial, graphic, or sculptural works, including the individual images of a motion picture or other audiovisual work, to display the copyrighted work publicly; and
- (6) in the case of sound recordings, to perform the copyrighted work publicly by means of a digital audio transmission.

*Id.*

copyrighted works granted by section 106(3), is expressly limited by section 109 of the Copyright Act. Section 109(a) states: “Notwithstanding the provisions of section 106 (3), the owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord.”<sup>209</sup> This limitation represents what is known as the “first sale doctrine” through which a restraint on alienation occurs once the copyright owner has sold the first copy of a copyrighted work, triggering future restrictions on sale by possessors.<sup>210</sup>

The law appears to be clear: (a) copyright owners are given important exclusive rights to control distribution of their copyrighted material, up to a point; and (b) subject to the limitations imposed under section 109(a), third parties who gain possession of a copyrighted item can sell or dispose of that copy.<sup>211</sup> Unfortunately, unwilling or unable to leave well enough alone, Congress muddied the waters by inserting section 602 into the Copyright Act.<sup>212</sup>

Section 602(a) prohibits the importation into the United States “without the authority of the owner of copyright . . . copies or phonorecords of a work that have been acquired outside the United States[, which are] an infringement of the exclusive right to distribute copies or phonorecords under section 106.”<sup>213</sup>

At the junction of sections 109 and 602, the nexus between parallel importation and copyright comes into play. In effect, Congress planted a minefield. Contradiction is ripe in sections 109 and 602. On one hand, section 109(a) appears to give possessors of a copyrighted work the right to sell or dispose of the work. On the other hand with respect to international acquisition, the possessor of the copyrighted work must have the authority of the copyright owner to distribute the work.

This later contradiction set the stage for inevitable litigation. Most of the litigation has focused on reconciling section 109 with section 602. Only one case has come before the Supreme Court over the

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<sup>209</sup> § 109(a).

<sup>210</sup> See, e.g., Judith Klerman Smith, Comment, *The Computer Software Rental Act: Amending the “First Sale Doctrine” to Protect Computer Software Copyright*, 20 LOY. L.A. L. REV. 1613, 1624–25 (1987) (defining the first sale doctrine).

<sup>211</sup> § 109(a).

<sup>212</sup> See § 602.

<sup>213</sup> § 602(a)(1).

incongruence of sections 109 and 602, *Quality King Distributors, Inc. v. L'anza Research International, Inc.*<sup>214</sup> Before looking at *Quality King*, it is important to look first at earlier decisions that set the stage for the case.

*B. Judicial Interpretation of the Copyright Act*

*I. Columbia Broadcasting System, Inc. v. Scorpio Music Distributors, Inc.*

In *Columbia Broadcasting System, Inc. v. Scorpio Music Distributors, Inc.* (Scorpio),<sup>215</sup> the conflict between sections 109 and 602 came into focus. Columbia Broadcasting System, Inc. (Columbia), a New York corporation, owned “copyrights to six sound recordings, copies of which compris[ed] the subject matter of [the] copyright infringement case” in *Columbia Broadcasting System, Inc. v. Scorpio Music Distributors, Inc.*<sup>216</sup> “On . . . January 1, 1981, CBS-Sony, Inc. [CBS-Sony], a Japanese corporation, entered into two written agreements with Vicor Music Corporation (Vicor), a Philippines corporation, by which Vicor was authorized to manufacture and sell . . . phonorecords exclusively in the Philippines.”<sup>217</sup> Columbia, which had retained the U.S. copyrights for the recordings, “consented to the agreement between CBS-Sony and Vicor.”<sup>218</sup> CBS-Sony and Vicor agreed that, following termination of the agreements, Vicor would have sixty days to liquidate its stock of phonorecords.<sup>219</sup>

On November 2, 1981, after giving notice, CBS-Sony terminated the manufacturing and licensing agreement with Vicor.<sup>220</sup> However, prior to that date on June 12, 1981, Scorpio Music Distributors, based in Pennsylvania, entered into an agreement to purchase several thousand phonorecords from International Traders, Inc., a Nevada corporation.<sup>221</sup> Approximately six thousand records ordered from International Traders were copies of the recordings owned under

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<sup>214</sup> See 98 F.3d 1109 (1996).

<sup>215</sup> 569 F. Supp. 47 (E.D. Penn. 1983).

<sup>216</sup> *Id.* at 47.

<sup>217</sup> *Id.*

<sup>218</sup> *Id.*

<sup>219</sup> *Id.*

<sup>220</sup> *Id.*

<sup>221</sup> *Id.*

copyright by Columbia.<sup>222</sup> “International Traders bought the phonorecords from Rainbow Music, Inc., a Philippines corporation, which had purchased them from Vicor” before the sixty-day liquidation period had expired.<sup>223</sup>

On February 1, 1982, Columbia sued Scorpio alleging that, in violation of section 602(a), Scorpio had illegally imported the phonorecords without the consent and authorization of Columbia.<sup>224</sup> After discovery, Columbia filed a motion for summary judgment and Scorpio filed a cross-motion for dismissal.<sup>225</sup> Scorpio argued that under the first sale doctrine, applied through the sale from Vicor to Rainbow, Scorpio had not infringed Columbia’s copyright.<sup>226</sup> Scorpio alleged that “§ 109(a) supersedes any relevance § 602 otherwise might have to the case.”<sup>227</sup> Granting the motion for summary judgment in Columbia’s favor, the court noted that Scorpio’s

contentions would be more persuasive were it not for the phrase—lawfully made under this title—in § 109(a) [that] the section grants first sale protection to the third party buyer of copies which have been legally manufactured and sold within the United States and not to purchasers of imports such as are involved here.<sup>228</sup>

The court reasoned that:

[D]eclaring legal the act of purchasing from a United States importer who . . . buys recordings which have been liquidated overseas, would undermine the purpose of the statute. The copyright owner would be unable to exercise control over copies of the work which entered the American market in competition with copies lawfully manufactured and distributed under this title.<sup>229</sup>

The *Scorpio* court based its rationale on the fact that the phonorecords were produced abroad and the sales occurred abroad, thereby bringing the activity under the purview of section 602.<sup>230</sup>

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<sup>222</sup> *Id.*

<sup>223</sup> *Id.*

<sup>224</sup> *Id.*

<sup>225</sup> *Id.* at 48.

<sup>226</sup> *Id.*

<sup>227</sup> *Id.* at 49.

<sup>228</sup> *Id.*

<sup>229</sup> *Id.*

<sup>230</sup> *See id.*

“The court concluded that ‘lawfully made under this title’ meant made within the United States.”<sup>231</sup>

The *Scorpio* decision provided ammunition to copyright owners in the battle to exclude gray market imports. The first round resulted in a victory for copyright owners. In the second round, copyright owners would not be so fortunate.

## 2. *The Third Circuit Weighs in on the Gray Market: Sebastian International, Inc. v. Consumer Contacts (PTY) Ltd.*

In *Sebastian International, Inc. v. Consumer Contacts (PTY) Ltd.*, the U.S. Court of Appeals for the Third Circuit vacated the district court’s order issuing a preliminary injunction based on alleged copyright infringement.<sup>232</sup> The court noted at the outset: “This case comes to us in the guise of an alleged copyright infringement but, in reality, is an attempt by a domestic manufacturer to prevent the importation of its own products by the ‘gray market.’”<sup>233</sup> Sebastian International, Inc. (Sebastian), a California company, manufactured and marketed personal beauty care supplies.<sup>234</sup> Specifically, two of its products, “WET” and “SHPRITZ FORTE,” carried “copyrights for the text and artistic content of their labels.”<sup>235</sup> Sebastian established a marketing policy restricting retail sales of its products to professional salons.<sup>236</sup> This strategy was designed to foster Sebastian’s image, reputation, and commercial success.<sup>237</sup>

In 1986, Sebastian entered into an oral contract with Consumer Contacts (PTY) Ltd., a South African corporation doing business under the name 3-D Marketing Services (3-D), in which 3-D agreed to distribute Sebastian beauty products in South Africa exclusively.<sup>238</sup> Sebastian shipped four cases of “WET” and “SHPRITZ FORTE” and other products valued at \$200,000 to 3-D in South Africa in January

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<sup>231</sup> Maureen M. Cyr, Note, *Determining the Scope of a Copyright Owner’s Right to Bar Imports: L’Anza Research International, Inc. v. Quality King Distributors*, 73 Wash. L. Rev. 81, 91–92 (1998).

<sup>232</sup> *Sebastian Int’l, Inc. v. Consumer Contacts (PTY) Ltd.*, 847 F.2d 1093, 1099 (3d Cir. 1988).

<sup>233</sup> *Id.* at 1094.

<sup>234</sup> *Id.*

<sup>235</sup> *Id.*

<sup>236</sup> *Id.*

<sup>237</sup> *Id.*

<sup>238</sup> *Id.*

of 1987.<sup>239</sup> 3-D received the shipment and then reshipped the unopened containers back to the United States in May 1987.<sup>240</sup> One week later, Sebastian filed suit, seeking a preliminary injunction against 3-D for alleged breach of contract; later, Sebastian amended the complaint to include a count for copyright infringement.<sup>241</sup> After surveying the limited case law, the district court issued the preliminary injunction on the strength of section 602, holding the “copyright holder has a right to control importation of copies, regardless of where they were made and despite the occurrence of a ‘first sale.’”<sup>242</sup>

The Third Circuit concluded that sections 109 and 602 were “provisions . . . intended to function interdependently and may be read in harmony with each other.”<sup>243</sup> In vacating the preliminary injunction, the court stated its decision “reconciles sections 106(3) and 602(a) by reasoning that the importation prohibition does not enlarge the distribution rights, but serves only as a specific example of those rights subject still to the first sale limitation.”<sup>244</sup> The court held that “a first sale by the copyright owner extinguishes any right later to control importation of those copies.”<sup>245</sup>

### 3. *Quality King Distributors, Inc. v. L’anza Research International, Inc.: The Final Volley in the War?*

*Quality King Distributors, Inc. v. L’anza Research International, Inc. (Quality King)*, represented the first gray market case the U.S. Supreme Court had heard under copyright law.<sup>246</sup> L’anza Research

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<sup>239</sup> *Id.*

<sup>240</sup> *Id.*

<sup>241</sup> *Id.* at 1094–95.

<sup>242</sup> *Id.* at 1095.

<sup>243</sup> *Id.* at 1097.

<sup>244</sup> *Id.*

<sup>245</sup> *Id.* at 1099. Commenting on the underlying controversy—gray market importation—the court offered the following insight:

Although this case turns purely on copyright law, we recognize that the underlying “gray market,” or “parallel importing,” issues really are dominant. . . . This twist has created the anomalous situation in which the dispute at hand superficially targets a product’s label, but in reality rages over the product itself. We think that the controversy over “gray market” goods, or “parallel importing,” should be resolved directly on its merits by Congress, not by judicial extension of the Copyright Act’s limited monopoly.

*Id.* (citation omitted).

<sup>246</sup> See *Quality King Distribs., Inc. v. L’anza Research Int’l, Inc.*, 523 U.S. 135 (1998).

International, Inc. (L'anza), a California-based manufacturer and distributor of shampoos, conditioners, and other hair care products, sold its high-quality products to authorized vendors, such as beauty salons and colleges.<sup>247</sup> Abroad, L'anza sold its products to "master distributors," which were contractually obligated to sell those products in defined geographical areas.<sup>248</sup> L'anza's master distributors paid approximately thirty-five to forty percent less for L'anza products than domestic distributors.<sup>249</sup> L'anza justified such price discrimination on the fact that master distributors do not receive the benefit of L'anza's extensive advertising and promotional activities conducted in the United States, and the master distributors were forced to market their products themselves.<sup>250</sup> In every foreign shipment, L'anza marked some of its bottles to allow for tracing.<sup>251</sup>

In February of 1994, L'anza discovered that several of its products were being sold at Vessey Drugs, a California drugstore.<sup>252</sup> L'anza determined, through tracing, that the products Vessey Drugs was selling had been purchased from L. Intertrade, a L'anza distributor in Malta, and imported without L'anza's permission by Quality King Distributors.<sup>253</sup> Originally, the products were manufactured in the United States by L'anza and then sold to L'anza's distributor in the United Kingdom, Planetary Eco, then to L. Intertrade.<sup>254</sup> Consistent with its pricing policy, "L'anza sold the products at a substantial discount with the understanding that [it] would be distributed in Malta, and possibly Libya."<sup>255</sup> Instead, L. Intertrade sold the products L'anza shipped to Planetary Eco in the United Kingdom for reimportation in the United States.<sup>256</sup>

L'anza brought suit against Quality King for selling its products, alleging that Quality King's sale of L'anza products infringed L'anza's copyright under section 602(a) of the Copyright Act of 1976. At trial, Quality King raised the first sale doctrine, section

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<sup>247</sup> *Id.* at 138.

<sup>248</sup> *L'anza Research Int'l, Inc. v. Quality King Distribs., Inc.*, 98 F.3d 1109, 1111 (9th Cir. 1996).

<sup>249</sup> *Id.*

<sup>250</sup> *Id.*

<sup>251</sup> *Id.*

<sup>252</sup> *Id.*

<sup>253</sup> *Id.*

<sup>254</sup> *Id.*

<sup>255</sup> *Id.*

<sup>256</sup> *Id.*



109(a), as an affirmative defense to its importation and sale of L'anza products. On July 25, 1995, the federal district court issued an order permanently enjoining Quality King from importing and selling L'anza products.<sup>257</sup> On September 29, 1995, the court entered a judgment in the amount of \$132,616 in favor of L'anza, as stipulated by the parties.<sup>258</sup>

On appeal to the Ninth Circuit, Quality King alleged that the district court erred by rejecting its first sale defense and declining to adopt the Third Circuit's holding in *Sebastian International, Inc. v. Consumer Contacts (PTY) Ltd.*<sup>259</sup> After a lengthy discussion of the case law, the Ninth Circuit upheld the district court's decision, holding that the first sale doctrine did not apply to Quality King because the doctrine "presupposes that the copyright owner will be able to realize the full value of each authorized copy . . . upon its first sale to a purchaser."<sup>260</sup> According to the court, this did not happen in L'anza's situation, because L'anza intended that its product be sold outside the United States and not reach the U.S. market.<sup>261</sup>

The Supreme Court noted that the "question presented by this case is whether the right granted by § 602(a) is . . . limited by §§ 107 through 120. More narrowly, the question is whether the 'first sale' doctrine endorsed in § 109(a) is applicable to imported copies."<sup>262</sup> Observing that L'anza's products were produced in the United States, the Supreme Court reversed the Ninth Circuit, holding that:

After the first sale of a copyrighted item "lawfully made under this title," any subsequent purchaser, whether from a domestic or from a foreign reseller, is obviously an "owner" of that item. Read literally, § 109(a) unambiguously states that such an owner "is entitled, without the authority of the copyright owner, to sell" that item. Moreover, since § 602(a) merely provides that unauthorized importation is an infringement of an exclusive right "under section 106," and since that limited right does not encompass resales by lawful owners, the literal text of § 602(a) is simply inapplicable to

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<sup>257</sup> *Id.* at 1112.

<sup>258</sup> *Id.*

<sup>259</sup> *Id.* (citing *Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd.*, 847 F.2d 1093 (3d Cir. 1988)).

<sup>260</sup> *Id.* (omission in original) (quoting 1 GOLDSTEIN, COPYRIGHT § 5.5, at 588–89 (2d ed. 1996)).

<sup>261</sup> *Id.* at 1114.

<sup>262</sup> *Quality King Distribs., Inc. v. L'anza Research Int'l, Inc.*, 523 U.S. 135, 138 (1998).

both domestic and foreign owners of L'anza's products who decide to import them and resell them in the United States.<sup>263</sup>

The Supreme Court cleared the way for importation of gray market copyrighted goods. The Court rejected L'anza's construction of section 602(a), which grants rights distinct from section 106(3) and section 109(a) standing alone. With respect to sections 106(3) and 109(a), the Court noted "[i]f § 602(a) functioned independently, none of those sections [107 through 120] would limit its coverage."<sup>264</sup> Thus, "[t]he whole point of the first sale doctrine is that once the copyright owner places a copyrighted item in the stream of commerce by selling it, he has exhausted his exclusive statutory right to control its distribution."<sup>265</sup> In a concurring opinion, Justice Ginsburg made the following important observation: "This case involves a 'round trip' journey, travel of the copies in question from the United States to places abroad, then back again. I join the Court's opinion recognizing that we do not today resolve cases in which the allegedly infringing imports were manufactured abroad."<sup>266</sup> Justice Ginsburg's concurrence was poignant and prophetic. Clearly, the debate was not finished.

#### 4. *Omega S.A. v. Costco Wholesale Corp.: The Gray Market Saga Continues*

In *Omega S.A. v. Costco Wholesale Corp.*, the U.S. Court of Appeals for the Ninth Circuit was forced to

address whether the Supreme Court's decision in *Quality King Distributors, Inc. v. L'anza Research International, Inc.*, . . . requires [the court] to overrule . . . precedents that allow a defendant in a copyright infringement action to claim the "first sale doctrine" of 17 U.S.C. § 109(a) as a defense only where the disputed copies of a copyrighted work were either made or previously sold in the United States with the authority of the copyright owner.<sup>267</sup>

Omega S.A. (Omega) filed claims against Costco for infringing importation and unauthorized distribution of "Omega watches bearing a design registered with the U.S. Copyright Office," under 17 U.S.C.

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<sup>263</sup> *Id.* at 145.

<sup>264</sup> *Id.* at 150.

<sup>265</sup> *Id.* at 152.

<sup>266</sup> *Id.* at 154 (Ginsburg, J., concurring).

<sup>267</sup> *Omega S.A. v. Costco Wholesale Corp.*, 541 F.3d 982, 983 (9th Cir. 2008) (citation omitted).

§§ 106(3) and 602(a).<sup>268</sup> “The district court granted summary judgment to Costco on the basis of the first sale doctrine” and awarded substantial attorneys’ fees to Costco.<sup>269</sup>

Omega manufactures luxury watches in Switzerland and sells them globally through authorized distribution networks consisting of distributors and retailers.<sup>270</sup> Omega engraved the watches in question with an “Omega Globe Design” on their undersides that was registered and copyrighted in the United States.<sup>271</sup> Costco obtained the copyrighted watches on the gray market.<sup>272</sup> First, Omega sold the watches to authorized dealers abroad.<sup>273</sup> “Unidentified third parties eventually purchased the watches and sold them to ENE Limited, a New York company, which in turn sold them to Costco. Costco then sold the watches to consumers in California.”<sup>274</sup> The Court observed: “Although Omega authorized the initial foreign sale of the watches, it did not authorize their importation into the United States or the sales made by Costco.”<sup>275</sup>

Both Omega and Costco moved for summary judgment.<sup>276</sup> Costco filed a cross-motion for summary judgment alleging that under 17 U.S.C. § 109(a), “the first sale doctrine, Omega’s initial foreign sale of the watches precludes claims of infringing distribution . . . in connection with the subsequent, unauthorized sales.”<sup>277</sup> On cross-motions for summary judgment, without explanation, the district court ruled in favor of Costco and awarded \$373,003.80 in attorneys’ fees.<sup>278</sup>

In the face of the U.S. Supreme Court decision in *Quality King*, the Ninth Circuit was faced with a dilemma. Did *Quality King* mean that

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<sup>268</sup> *Id.*

<sup>269</sup> *Id.*

<sup>270</sup> *Id.*

<sup>271</sup> *Id.*

<sup>272</sup> *Id.* at 984.

<sup>273</sup> *Id.*

<sup>274</sup> *Id.*

<sup>275</sup> *Id.*

<sup>276</sup> *Id.*

<sup>277</sup> *Id.* With respect to the first sale doctrine, the Court observed the following: “This . . . section codifies the so-called ‘first sale doctrine,’ which holds that ‘[o]nce [a] copyright owner consents to the sale of particular copies of his work, he may not thereafter exercise the distribution right with respect to those copies.’” *Id.* at 985 (alterations in original) (quoting 2-8 MELVILLE B. NIMMER & DAVID NIMMER, NIMMER ON COPYRIGHT § 8.12(B)(1), at 8-156 (1978)).

<sup>278</sup> *Id.*

the first sale doctrine provides an almost-blanket defense to gray market importers who import copyrighted goods? In *Omega S.A. v. Costco Wholesale Corp.*, the Ninth Circuit held “that *Quality King* did not invalidate our general rule that § 109(a) can provide a defense against §§ 106(3) and 602(a) claims only insofar as the claims involve domestically made copies of U.S.-copyrighted works.”<sup>279</sup> In order to reach this conclusion, the Ninth Circuit examined precedent to determine the scope of the first sale doctrine.<sup>280</sup> Turning squarely to the impact of *Quality King*, the court observed the following:

It is clear that *Quality King* did not directly overrule *BMG Music*, *Drug Emporium*, and *Denbicare*. *Quality King* involved “round trip” importation: a product with a U.S.-copyrighted label was manufactured inside the United States, exported to an authorized foreign distributor, sold to unidentified third parties overseas, shipped back into the United States without the copyright owner’s permission, and then sold in California by unauthorized retailers. . . . The Court held that § 109(a) can provide a defense to an action under § 602(a) in this context. . . . However, because the facts involved only domestically manufactured copies, the Court did not address the effect of § 109(a) on claims involving unauthorized importation of copies made abroad. . . . “[W]e do not today resolve cases in which the allegedly infringing imports were manufactured abroad.”<sup>281</sup>

As noted above, the Ninth Circuit points out that within the context of the *Quality King* decision, the first sale doctrine has to be viewed as a valid defense only in a situation where the U.S. copyright holder is the victim of gray market importation in a “round trip” situation. In *Omega*, the Ninth Circuit explicitly notes that the first sale doctrine may not be a defense when the U.S. copyright holder manufactures products abroad, which are then imported by a third party to compete with sales of copyrighted goods in the United States.<sup>282</sup> The Ninth Circuit noted that “[t]he basis for that rule was our concern that applying § 109(a) to foreign-made copies would violate the presumption against the extraterritorial application of U.S. law.”<sup>283</sup>

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<sup>279</sup> *Id.*

<sup>280</sup> *Id.* at 985–86.

<sup>281</sup> *Id.* at 987 (citations omitted) (alteration in original) (quoting *Quality King Distribs., Inc. v. Lanza Research Int’l, Inc.*, 523 U.S. 135, 154 (1998) (Ginsburg, J., concurring)).

<sup>282</sup> *Id.* at 990.

<sup>283</sup> *Id.* at 987.

We reject Costco’s contention and hold that the Supreme Court’s brief discussion on extraterritoriality is not “clearly irreconcilable” with our general limitation of § 109(a) to copies that are lawfully made in the United States. . . .

The Ninth Circuit reasoned that following Costco's argument concerning application of the first sale doctrine in a non-"round trip" case would lead to a rather absurd result. "Given this understanding of the presumption, the application of § 109(a) to foreign-made copies would impermissibly apply the Copyright Act extraterritorially in a way that the application of the statute after foreign sales does not."<sup>284</sup> To buttress this point, the Ninth Circuit drew from an illustration in *Quality King*:

The Court stated that given "a publisher of [a] U.S. edition [of a work] and a publisher of [a] British edition of the same work, each such publisher could make lawful copies. If the author of the work gave the exclusive United States distribution rights—enforceable under the Act—to the publisher of the United States edition and the exclusive British distribution rights to the publisher of the British edition, however, *presumably only those made by the publisher of the United States edition would be 'lawfully made under this title' within the meaning of § 109(a).* The first sale doctrine would not provide the publisher of the British edition who decided to sell in the American market with a defense to an action under § 602(a)." . . . Assuming the British edition was made outside the United States, . . . this illustration suggests that "lawfully made under this title" refers exclusively to copies of U.S.-copyrighted works that are made domestically. Were it otherwise, the copies made by the British publisher would also fall within the scope of § 109(a).<sup>285</sup>

In *Omega*, the Ninth Circuit explicitly ruled that the first sale doctrine was not a defense for Costco. Specifically, the Ninth Circuit held that precedent was not inconsistent and irreconcilable with *Quality King*.<sup>286</sup> In reaching this holding, the Ninth Circuit observed:

In summary, our general rule that § 109(a) refers "only to copies legally made . . . in the United States" . . . is not clearly irreconcilable with *Quality King*, and, therefore, remains binding precedent. Under this rule, the first sale doctrine is unavailable as a defense to the claims under §§ 106(3) and 602(a) because there is no genuine dispute that Omega manufactured the watches bearing the Omega Globe Design in Switzerland.

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The common understanding of the presumption against extraterritoriality is that a U.S. statute "appl[ies] only to conduct occurring within, or having effect within, the territory of the United States, unless the contrary is clearly indicated by the statute."

*Id.* at 987–88 (citation omitted) (alteration in original).

<sup>284</sup> *Id.* at 988.

<sup>285</sup> *Id.* at 989 (alteration in original) (citation omitted) (footnote omitted) (quoting *Quality King Distribs., Inc.*, 523 U.S. at 148.

<sup>286</sup> *Id.* at 990.

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. . . There is no genuine dispute that the copies of the Omega Globe Design were sold in the United States without Omega's authority. The exception, therefore, does not apply in this case.<sup>287</sup>

Recently, the U.S. Supreme Court granted Costco certiorari.<sup>288</sup> Perhaps the Court will provide a clear answer to the question of whether the first sale doctrine applies to copyrighted goods that are manufactured abroad and imported into the United States without the authority of the copyright holder. The Supreme Court will write the sequel to the gray market saga.

#### IV

##### THE INTERSECTION OF TORTS LAW AND THE GRAY MARKET

As this Article has demonstrated, excluding gray market goods through litigation is an extremely difficult task. Under trademark law, efforts to invalidate the Customs Service's interpretation of the Tariff Act and the Lanham Act have largely been unsuccessful. Under section 602(a) of the Copyright Act, the result has been the same. The common law tort of intentional interference with contract relations has emerged as an alternative means to attack the phenomena of parallel importation.<sup>289</sup> "This cause of action is usually brought when the mark is not registered in the United States or when plaintiff is unable to establish injury by illegal grey-market importing under section 526."<sup>290</sup> The cause of action has four elements: (1) the plaintiff must show that a valid contract exists, (2) the plaintiff must show that the defendant knew the contract existed, (3) the defendant must intentionally cause breach, and (4) damages must result from the defendant's intentional breach of the contract.<sup>291</sup>

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<sup>287</sup> *Id.* (first omission in original) (citations omitted).

<sup>288</sup> See Petition for a Writ of Certiorari, *Costco Wholesale Corp. v. Omega S.A.*, No. 08-1423 (May 18, 2009).

<sup>289</sup> See generally Millrood, *supra* note 76, at 359.

<sup>290</sup> Harry Rubin, *Destined to Remain Grey: The Eternal Recurrence of Parallel Imports*, 26 INT'L LAW. 597, 610 (1992).

<sup>291</sup> RESTATEMENT (SECOND) TORTS § 766 (1979).

One who intentionally and improperly interferes with the performance of a contract . . . between another and a third person by inducing or otherwise causing the third person not to perform the contract, is subject to liability to the other for the pecuniary loss resulting to the other from the failure of the third person to perform the contract.

*Id.*

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Practically speaking, how could an American manufacturer take steps to protect its interests with regard to the gray market through use of American tort law? The American manufacturer would have to take four critical steps to ensure that a tort cause of action would exist to thwart gray market importation. First, it is important for a manufacturer to create and maintain strong distribution and licensing contracts with distributees and licensees. This helps meet the first element outlined above. Second, manufacturers can make their contracts known to third parties through clear and distinct product labels and warnings, which strongly caution against and deem gray market importation to be illegal, integrated in their products or as part of their wrapping and packaging. This would help meet the second element. Third, by establishing product labels and warnings that notify third parties, intentional, voluntary, and volitional breach of the label warning against gray market importation by such parties would be easy to demonstrate. This complies with the third element of the cause of action. Fourth, a strong inventory and product-tracking protocol and system would enable the manufacturer to detect and quantify goods that are imported through the gray market to compete with domestic products. This would go a long way toward quantifying damages and thereby meeting the fourth and final element outlined above. A handful of cases have examined intentional interference with performance of contract by a third party.

In *DEP Corp. v. Interstate Cigar Co.*, DEP Corporation (DEP), the plaintiff, had an exclusive contract to distribute soap in the United States absent trademark rights and assignment.<sup>292</sup> Interstate Cigar Company, the defendant, began purchasing the soap from third parties in Europe, and then importing and selling it at lower prices than DEP.<sup>293</sup> The Second Circuit, on appeal, suggested that absent any property rights in the trademark, DEP could bring a cause of action based on intentional interference with contract relations under the exclusive dealing agreement.<sup>294</sup>

Similarly, in *Railway Express Agency, Inc. v. Super Scale Models, Ltd.*, a toy train distributor brought an action against a competitor for intentional interference with the distributor's existing contract with a German-based toy train manufacturer by rendering the contract less

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<sup>292</sup> *DEP Corp. v. Interstate Cigar Co.*, 622 F.2d 621, 621 (2d Cir. 1980).

<sup>293</sup> *Id.*

<sup>294</sup> *Id.* at 624.

profitable for the distributor.<sup>295</sup> The trademarks for the toy trains were registered in Germany, not the United States.<sup>296</sup> Thus, Railway Express, the plaintiff, did not have a cause of action for trademark infringement or exclusion under customs law. Instead, Railway Express commenced suit under a theory of intentional interference with contract relations.

The Seventh Circuit held that Railway Express failed to prove an essential element of the tortious interference claim: damage or injury. However, the court stated that Railway Express “could have established the requisite damage in any of a number of ways.”<sup>297</sup> For example, the plaintiff could have presented evidence that the defendant damaged Railway Express’s “ability to sell E.P. Lehmann’s product by selling an inferior grade of LGB merchandise or by creating consumer confusion concerning the quality of LGB equipment [or] by demonstrating that [the defendant] made sales to . . . existing clientele.”<sup>298</sup> As the plaintiff made no such attempt, the court dismissed the claim.<sup>299</sup>

As this examination of the case law demonstrates, tort law may present a viable means to thwart gray market importation. As with any tort, the plaintiff has the burden of proving all elements. As the *Railway Express Agency* case demonstrated, the prospective plaintiff must zealously ensure that it can prove all elements of its claim. Taking the steps outlined above, a plaintiff could sustain an action for intentional interference with performance of contract by a third person.

#### CONCLUSION

At the outset of this Article, I posed the following question: Ever wonder how you got that camera, television, or other product so cheap? As this Article has demonstrated, when one digs below the surface, the likely answer is that that camera, television, or other cheap product came from a gray market source. American trademark or copyright holders may never stop that camera, television, or other product obtained on the gray market from competing with and

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<sup>295</sup> *Ry. Express Agency, Inc. v. Super Scale Models, Ltd.*, 934 F.2d 135, 136 (7th Cir. 1991).

<sup>296</sup> *Id.* at 136.

<sup>297</sup> *Id.* at 140.

<sup>298</sup> *Id.*

<sup>299</sup> *See id.* at 141.



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undercutting the sale of their domestically manufactured American products. The challenge is difficult and daunting, especially for the unsavvy and unwary. The gray market is vast and lucrative. Many goods fall victim to the gray market. It would not exist if people were not concerned with making large sums of money—the profit motive is supreme in our society.

As this Article has demonstrated, gray market importation has become a contentious issue in international-trade circles. Efforts of trademark and copyright holders to exclude gray market goods through trademark, customs, and copyright law have largely failed. At least in the United States, judicial and administrative interpretation of the law has opened the door to gray market goods. For the moment, parallel importation is a legal practice. American manufacturers would be wise to consider an action based on intentional interference with performance of contract by a third person as a viable means and legal strategy to hold back the tide of gray market goods. Tort law may offer a viable solution to a complex and challenging problem.

