GRAY MARKET GOODS PRODUCED BY FOREIGN AFFILIATES OF THE U.S. TRADEMARK OWNER: SHOULD THE LANHAM ACT PROVIDE A REMEDY?

by

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I. INTRODUCTION

In *K Mart Corp. v. Cartier, Inc.*, the United States Supreme Court upheld regulations of the Customs Service that permit gray market goods to enter the U.S. market where the foreign and domestic trademark owners have a unity of interest. The regulations at issue were promulgated pursuant to the section 526 of the Tariff Act of 1922, which prohibits the importation of goods of foreign manufacture where the goods bear a registered trademark "owned by" a U.S. citizen or corporation without the consent of the owner. Having failed in their attempt to make this trade provision a viable means by which to exclude gray goods originating from affiliated sources, domestic distributors have increasingly turned to the trademark laws for relief. The question thus arises whether this regime does or should provide relief from such intrabrand competition or whether resort to other remedies would be more appropriate.

I shall argue that, with limited exceptions, the problem posed by genu-
ine gray market imports from an affiliated source is not a trademark problem per se, and as such federal relief must come from Congress in the form of *sui generis* legislation. First, I shall briefly examine the historical background of this problem and discuss the debate leading up to the *K Mart* decision. Second, I shall discuss the nature of the trademark right, provisions under the Lanham Act that safeguard that right and several illustrative gray market cases decided thereunder. Third, I shall discuss the relationship between the trademark standard for regulating gray market goods and the ability of the trademark owner to avoid intrabrand competition. Fourth, I shall conclude by proposing an infringement standard under which gray market goods should be measured that considers the interests of trademark owners, consumers and competition in the marketplace.

II. BACKGROUND: FROM *KATZEL* TO *K MART*

There are several interrelated economic explanations for the existence of gray markets. As a starting point, there must be a positive disparity in price between the U.S. market and the market in which the goods are purchased for domestic resale. This price differential may arise for innocuous reasons, including differing production, marketing, warranty, insurance and safety compliance costs, or simply differences in the quality of products driven by dissimilar consumer preferences. It may, however, exist because the producer is price discriminating — i.e., charging the domestic consumer a price higher than his foreign counterpart. Regardless of the reason for the price gap, it may be further influenced by national currency fluctuations. And in all cases, if the price difference exceeds transportation costs, the gray marketeer may profitably sell the goods domestically and erode the higher domestic price.

At bottom, gray market goods create a problem for domestic trademark holders because they are distributed through importers at prices less than those at which the goods are sold by authorized distributors. Trademark owners argue that gray goods undermine the domestic goodwill associated with the mark, create confusion in the marketplace, and compete unfairly with authorized goods by way of free riding on the efforts of the authorized distribu-

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5. See id.
6. Id.
7. Id. at 375-77.
8. Id. at 377.
9. Id. at 374-75.
10. This phenomenon occurs in the trademark context where a competitor of the holder of
Proponents of the gray market, by contrast, assert that since the goods are genuine and the mark authentic, the American consumer should be permitted to benefit from the lower prices available based upon notions of free trade. Blocking these imports, they argue, enforces a division of markets, creates a higher price structure in the United States and thus has a significant anticompetitive effect.

A gray market may result from several different market arrangements. The first situation (Case 1) arises where a domestic firm purchases the exclusive U.S. distribution and trademark rights from an independent foreign firm who continues to produce the goods. A second context is where a domestic firm registers a mark for goods that are manufactured abroad by a firm which is a parent (Case 2(a)), a subsidiary (Case 2(b)) or a division (Case 2(c)) of the domestic producer. A third situation is where a domestic producer authorizes an independent foreign producer to use the mark in a market outside the United States (Case 3). In each arrangement, if the goods are imported into the U.S. market, the foreign manufactured goods will compete "on the gray market" with the U.S. trademark holder's goods.

A. A. Bourjois & Co. v. Katzel

Prior to 1923, several courts held that the use of a trademark on genuine imported goods did not constitute infringement and thus such importation could not be barred. Under this view, the merchandise carries the mark a valuable trademark duplicates the latter's mark in order to capture some of the revenue generated by the sale of goods under the trademark to unwary customers. Since the cost of duplicating a label or design is generally small, the incentive to do so is greater the stronger the mark.

11. See id. at 371-75.
13. See 3 MCCARTHY, supra note 2, at § 29.18[1].
14. These three scenarios are outlined by Justice Kennedy in K Mart Corp., 486 U.S. at 286-87.
15. Id. at 286.
16. Id.
17. Id. at 287.
18. Id.
20. In Apollinaris Co., Ltd. v. Scherer, 27 F. 18 (S.D.N.Y. 1886), the defendant imported spring water under the mark HYUNDI JANOS and sold it in competition with plaintiff, the trademark owner and exclusive U.S. distributor. The court refused to enjoin defendant from importing or selling the water because, in its view, "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." Id. at 20. See also Fred Gretsch Mfg. Co. v.
lawfully wherever it goes and does not infringe another’s exclusive rights to that same mark in a territory into which the merchandise is imported. However, in the first case of the so-called face powder trilogy, a new conception of the trademark right was to be adopted.

In *A. Bourjois & Co. v. Katzel*, a French producer of face powder assigned its federal registration and associated goodwill for the trademark JAVA to plaintiff, a U.S. company. After the assignment, the U.S. company continued to purchase the face powder from the French company and market it in the United States under the JAVA mark. Defendant, Anna Katzel, purchased the genuine powder in France and imported it for resale in the states under substantially the same mark, hoping to take advantage of a favorable exchange rate. In an action for trademark infringement, the trial court granted plaintiff’s motion for a preliminary injunction enjoining defendant’s sale of face powder under the JAVA mark. On appeal, the Second Circuit reversed, holding that because “the goods sold [were] the genuine goods covered by the trade-mark, the rights of the owner . . . are not infringed.”

On certiorari, the Supreme Court reversed the appellate court decree. The Court first rejected the universality principle embraced by the lower court in favor of a territoriality principle, which recognizes a separate legal existence for a trademark in each country whose law affords it protection. It also found that, through substantial expenditures for advertising and promotion, the plaintiff had acquired independent goodwill symbolized by the JAVA mark—i.e., domestic consumers perceived the source of the goods to be plaintiff. In concluding that this fact was sufficient to justify an injunction, the

Schoening, 238 F. 780, 781-82 (2d Cir. 1916).


23. *Id.* at 690-91.
24. *Id.* at 691.
27. *Id.* at 543.
29. *Id.* “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.” *Id.* See also *Restatement*, supra note 2, § 24, cmt. f (under this view the trademark does not necessarily identify to purchasers in a particular country the original manufacturer of the goods, but instead may identify the firm that has exclusive trademark rights within that country).
30. *Katzel*, 260 U.S. at 692. Defendant had argued that the mark was “that of the French house and truly indicate[d] the origin of the goods.” But the Court did not agree:
court observed that the trademark "stakes the reputation of the plaintiff upon the character of the goods" and thus should be protected.31

B. Section 526 of the Tariff Act and the Common Control Exception

While Katzel was pending in the Supreme Court, Congress acted to overturn the Second Circuit's decision. In 1922, it enacted section 526 of the Tariff Act of 192232 ("section 526") which prohibits importation of genuine goods bearing a registered mark owned by an American company even without a showing of consumer confusion.33 There is little doubt that this provision was a direct congressional response to the Second Circuit decision34 and that its purpose was to protect American trademark owners.35

Thus, under early decisions, the domestic trademark owner had no remedy against an importer of genuine goods. Katzel and section 526 of the Tariff Act, however, significantly changed the state of the law faced by importers of gray goods. Under Katzel, the U.S. trademark owner could obtain relief for trademark infringement where consumers recognized his mark as an independent designation of source. With section 526, Congress took the further step of prohibiting imports where the domestic trademark owner purchased the

But that is not accurate. It is the trademark 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.

Id. Although one court construed this language to create a per se rule of infringement, Roger & Gallet v. Janmarie, 245 F.2d 505, 511 (C.C.P.A. 1957), the decision has been understood to apply only to situations where the trademark indicates that the goods originate with the U.S. distributor. Brian D. Cogglo, Jennifer Gordon & Laura A. Coruzzi, The History and Present Status of Gray Goods, 75 TRADEMARK REP. 433, 450 (1985).


32. Genuine Goods Exclusion Act § 526, 42 Stat. 975 (1922). Later reenacted as section 526 of the Tariff Act of 1930, this statute makes it illegal to:

import into the United States [1] any merchandise of foreign manufacture if [2] such merchandise, or the label, . . . bears a trademark [3] owned by a citizen of, or by a corporation or association created or organized within, the United States, and [4] registered in the Patent and Trademark Office . . . and [5] if a copy of the certificate of registration of such trademark is filed with the Secretary of the Treasury . . . unless written consent of the owner of such trademark is produced at the time of making entry.


33. See id. See also 3 MCCARTHY, supra note 2, at § 29.19[2] (Section 526 "requires no proof of a likelihood of confusion.").

34. Judge Learned Hand once remarked that "[h]ad the Supreme Court reversed that decision last spring, it [Section 526] would not have been enacted at all." Coty Inc. v. LeBlume Import Co., 292 F. 264, 269 (S.D.N.Y.), aff'd, 293 F. 344 (2d Cir. 1923).

35. See H. R. Rep. No. 1223, 67th Cong., 2d Sess., 158 (1922). It is, however, uncertain whether the Congress intended to protect the trademark owner only where he had developed his own domestic good will. Cogglo, supra note 30, at 450 n. 109 and accompanying text.
mark and its associated goodwill from a foreign firm.\textsuperscript{36}

By statute, the United States Customs Service is authorized to issue regulations implementing section 526 and to prevent importation of offending goods.\textsuperscript{37} And although section 526 appears to be a general prohibition of unauthorized imports bearing a U.S. trademark, the Customs Service promulgated several significant exceptions to the import ban. The first, the so-called common control exception, permits the gray market imports to enter the U.S. market as non-infringing goods where both marks are owned by the same or affiliated companies.\textsuperscript{38} The second exception, the “authorized use” exception, allows entry where the trademark owner authorizes its use by a foreign producer.\textsuperscript{39} As the reader will recall, these exceptions to the general rule of exclusion represent gray good cases 2 and 3, outlined above.\textsuperscript{40}

The common control and authorized use exceptions to the section 526 import ban are thought to have been influenced by the decision in \textit{United States v. Guerlain, Inc.}\textsuperscript{41} In \textit{Guerlain}, the Justice Department instituted antitrust actions against exclusive distributors of French toiletries.\textsuperscript{42} The defen-

\begin{itemize}
\item \textsuperscript{36} Cogglo, \textit{supra} note 30, at 450.
\item \textsuperscript{37} \textit{Restatement}, \textit{supra} note 2, § 24, cmt. e. The general Customs Service regulation provides that:

\begin{quote}
Foreign-made articles bearing a trademark identical with one owned and recorded by a citizen of the United States or a corporation or association created or organized within the United States are subject to seizure and forfeiture as prohibited importations.
\end{quote}

19 C.F.R. § 133.21(b) (1990).

\item \textsuperscript{38} The regulation provides that the restrictions of 19 C.F.R. § 133.21(b), are not applicable when:

\begin{enumerate}
\item Both the foreign and the U.S. trademark or trade name are owned by the same person or business entity;
\item The foreign and domestic trademark or trade name owners are parent and subsidiary companies or are otherwise subject to common ownership or control (see §§ 133.2(d) [defining “common ownership and common control”] and 133.12(d)[providing that application to record trademark must report identity of any affiliate that uses the trade name abroad]). . . .
\end{enumerate}

19 C.F.R. § 133.21(c) (1990).

\item \textsuperscript{39} The regulation provides that the restrictions of 19 C.F.R. § 133.21(b), \textit{supra} note 37, are further inapplicable when:

\begin{enumerate}
\item The articles of foreign manufacture bear a recorded trademark or trade name applied under authorization of the U.S. owner. . . .
\end{enumerate}

19 C.F.R. § 133.21(c) (1990).

\item \textsuperscript{40} \textit{See supra} notes 14-18 and accompanying text.


\item \textsuperscript{42} 155 F. Supp. at 79.
dants owned federal registrations taken by way of assignment of trademark rights from the French company, and imported the products for resale in the U.S. market under the same marks. In this consolidated action, the Government charged each defendant with violations of section 2 of the Sherman Act based upon their invocation of the protection of section 526. The court found that each defendant and its associated French company constituted a single international enterprise, and held that, as such, the domestic defendants could not seek to exclude parallel imports under section 526. The court concluded that "the purpose of the section [i.e., section 526] was to protect the rights of Americans who bought foreign trade-marks and that it was aimed at the Katz decision in the Court of Appeals, involving an American trademark owner independent of the foreign manufacturer." As such, the court held each defendant in violation of the Sherman Act and enjoined the continuation of the unlawful conduct.

On appeal to the Supreme Court, however, the Government moved to vacate the judgments, and the motion was granted. And on remand, the district court granted the Justice Department's motion to dismiss, with prejudice. The Government simply decided that the public interest would be better served by an attempt to obtain a legislative resolution to the same effect, although that justification is less than satisfying. Nonetheless, the district court's decision apparently did influence the Customs Service's antitrust policy and lead it to adopt the regulations that substantially narrowed the rights conferred by section 526. One court would later observe that:

While the district court's decision in Guerlain was subject to criticism,

43. Id.
44. 15 U.S.C. § 2 (1990). This section makes it an offense for a single firm to monopolize, attempt to monopolize, or combine or conspire to monopolize any part of the nation's interstate or foreign commerce.
45. Guerlain, 177 F. Supp. at 79.
46. Id. at 80.
47. Id. at 80-83.
48. Id. at 81 (citing 62 Cong. Rec. 11602, 11602-05). Later in its opinion, the court stated that, by enacting section 526, it was not "the intention of Congress to grant such a special privilege for the benefit of an international enterprise." Id. at 82.
49. Id. at 87-88 (finding the relevant market to be each brand named perfume, the court held that defendants' conduct was an unlawful attempt to exclude competition and set up an international price discrimination system).
52. Id. at 107. Such legislation that would adopt the holding of the District Court was proposed, H.R. 7234, 86th Cong., 1st Sess. (1959), reprinted in 49 TRADEMARK REP. 669 (1959), but was never enacted into law.
the trend of antitrust law prior to 1972 supported it and the Customs regulations. Indeed, in United States v. Arnold Schwinn & Co., the Supreme Court held that manufacturer-imposed restrictions on the distribution of products after those products were released into commerce were per se violations of the Sherman Act. Schwinn, however, was, as we know, overruled in Continental T.V., Inc. v. GTE Sylvania Inc., and this alone would seem to make reassessment of section 133.21(c) appropriate at least insofar as those regulations rest on antitrust considerations.54

Leading up to K Mart, however, the common control and authorized use regulations had retained their essential character notwithstanding the considerable reevaluation of the antitrust doctrine on which they are based.55

C. K Mart Corp. v. Cartier, Inc.56

In the 1980s, when the dollar had escalated in value vis-a-vis other national currencies, the gray market once again reared its head. It was during this period that trademark owners began to vigorously attack the validity of the Customs Service exceptions to the section 526 import ban because, inter alia, increased price competition from gray market products resulted in the loss of sales.57 They argued, in particular, that the regulations, that permit the importation of gray goods if the American and foreign trademarks are owned by the same entity (or affiliated entities) or if the American trademark owner has authorized the foreign entity to use the trademark, were inconsistent with the plain language as well as the legislative purpose of the statute.58 Leading cases from the lower federal courts deciding the legality of the regulations, however, resulted in a split in authority59 that would be resolved finally in K Mart.

The case history of K Mart is as follows. COPIAT, a trade group representing owners of U.S. trademarks, and several other complainants brought an action against the Customs Service seeking a declaratory judgment that the authorized use and common control exceptions were inconsistent with section


55. An examination of these provisions as a matter of contemporary antitrust law and policy is beyond the scope of this paper.


57. See Hahm, supra note 12, at 65.


59. Compare Vivitar Corp. v. United States, 761 F.2d 1552 (Fed. Cir. 1985), cert. denied, 474 U.S. 1055 (1986) (upheld regulations); Olympus Corp. v. United States, 792 F.2d 315 (same); with COPIAT, 790 F.2d 903 (invalidated regulations).
526 and thus invalid. As trademark owners exempted from the protection afforded by section 526, plaintiffs sought an injunction prohibiting the enforcement of the exceptions and compelling enforcement of the statute's express terms. Customs argued in defense of the regulations that they were based on a reasonable interpretation of section 526 by the agency charged with its enforcement. On cross motions for summary judgment, the district court upheld the regulations. On appeal, however, the Court of Appeals for the District of Columbia reversed the lower court. It held that section 526 prohibits gray market imports on its face and, alternatively, that the Custom Service's interpretation of the statute was unreasonable.

On certiorari, the U.S. Supreme Court upheld the appellate court's decision that the authorized use exception was an incorrect interpretation of section 526 but reversed the D.C. Circuit's holding that the common control exception was an unreasonable construction of the statute. The Court addressed the validity of the regulations by reference to three gray good market arrangements. In each case, according to the Court, the issue to be decided was (1) whether section 526 was sufficiently clear and unambiguous, in which case the Customs Service was required to give effect to the clear intent of Congress; and, if not, (2) whether the agency's interpretation was a permissible or reasonable construction of the statute.

The Court unanimously agreed that the agency could interpret the statu-

60. COPIAT, 790 F.2d at 904. K Mart Corp. and 47th Street Photo intervened as defendants and argued in favor of upholding the regulations.

Note that plaintiffs also challenged the regulations as being inconsistent with section 42 of the Lanham Trademark Act. Id. The appellate court, however, did not decide the question. Id. at 907. This question will, nonetheless, be examined below.

61. Id. at 903.

62. Under the doctrine of Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984), where a statute is ambiguous on its face as to a specific issue of law, reviewing courts are to give effect to the agency interpretation, provided it is a reasonable construction of the statute.

63. COPIAT, 790 F.2d at 904.

64. Id. at 905.

65. The court of appeals stated that "Section 526 confers an absolute, unqualified property right upon American companies that own registered trademarks." Id. at 910.

66. Id. at 916.


68. Id. at 292.

69. See supra text accompanying note 14.

70. Id. at 292 (citing Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467 U.S. 837, 842-43 (1984)).
ute to bar importation of gray-market goods in Case 1\textsuperscript{71} and to permit the imports in Case 2(a).\textsuperscript{72} The Justices, however, were divided over the remainder of the common control exceptions and authorized use exception. A majority upheld Case 2(b) and 2(c) as reasonable interpretations of the phrase "merchandise of foreign manufacture"\textsuperscript{73} but could not agree on the appropriate reasoning.\textsuperscript{74} The Court, moreover, concluded that the authorized use exemption (Case 3) could not be squared with the plain meaning of the section 526 and thus was invalid.\textsuperscript{75}

The Supreme Court's decision in \textit{K Mart}, in essence an administrative law decision, manifestly did not resolve important issues related to the gray market controversy, most notably whether trademark law provides a remedy against parallel imports produced by foreign affiliates. But, by upholding the common control exception to the section 526 import ban, the decision has the effect of impairing the ability of domestic trademark owners who are part of a multinational enterprise\textsuperscript{76} to control the importation of gray market goods.\textsuperscript{77}

\textsuperscript{71} The facts in \textit{Katzel}, \textit{supra} part II.A., are the paradigm situation in which to exclude gray goods. \textit{See also} \textit{Premier Dental Prods. v. Darby Dental Supply Co.}, 794 F.2d 850 (3d Cir.) (affirming grant of preliminary injunction against gray good importation), \textit{cert. denied}, 479 U.S. 950 (1986).

\textsuperscript{72} \textit{K Mart}, 486 U.S. at 292. The Court found the phrase "owned by" ambiguous in the context of a foreign parent and domestic subsidiary, reciting an example where the subsidiary was wholly owned, in which case the trademark is constructively owned by the parent not the subsidiary. \textit{Id.}

\textsuperscript{73} \textit{See supra} note 21.

\textsuperscript{74} Justice Kennedy stated that it is possible to interpret this language to mean, \textit{inter alia}, goods manufactured in a foreign country by a foreign company, and said: "Given the imprecision in the statute, the agency is entitled to choose any reasonable definition and to interpret the statute to say that goods manufactured by a foreign subsidiary or division of a domestic company are not goods 'of foreign manufacture.'" \textit{Id.} at 292-93. Justice Brennan's opinion, unlike Justice Kennedy's, emphasized the legislative history of Section 526 as well as the agency's prior interpretations of the statute in determining that the statute was indeed ambiguous and Customs' interpretation reasonable. In assessing the language of the statute, Justice Brennan observed that:

\textit{The most blatant hint that Congress did not intend to extend section 526's protection to affiliates of foreign manufacturers (case 2) is the provision's protectionist, almost jingoist, flavor. Its structure bespeaks an intent, characteristic of the times, to protect only domestic interests.}

\textit{Id.} at 297.

\textsuperscript{75} \textit{Id.} at 293-94. "Under 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." \textit{Id.} at 294.

\textsuperscript{76} The analysis in effect recognizes that domestic and foreign affiliates are to be considered as a single international enterprise with no right under section 526 to divide markets for the branded good.

\textsuperscript{77} Although, as a technical matter, the regulations do not define the correct meaning of section 526, courts have viewed the interpretation as controlling in a private suit brought
The ruling may indeed have the effect of promoting international licensing agreements over related company arrangements in order to prevent unwanted intrabrand competition. Some argue that this produces the undesirable consequence of uncertainty associated with investing money and trust in foreign licensees. The decision has also been criticized on other grounds. It has been asserted, more particularly, that the decision fails to provide any guidance as to how lower courts should determine whether companies are affiliated versus unrelated, and, as such, there is a risk that a foreign subsidiary owned by a domestic entity at a marginal percentage could be treated the same as a wholly owned foreign subsidiary. Finally, *K Mart* has been understood to create an unwarranted exception to the trademark territoriality principle as applied to multinational companies. This final criticism will be discussed in more detail below.

**III. THE LAMHAM ACT AND THE GRAY MARKET**

Enacted in 1946, the Lanham Act for the first time created a national trademark regime that recognized substantive, as well as procedural rights, in trademarks. The primary goals of the legislation were to secure to the owner the good will associated with its trademark, to prevent diversion of trade through commercial misrepresentations, and to protect the public against exposure to confusingly similar trademarks. Trademarks were viewed by the drafters as a device to stimulate competition because they identify and distinguish goods and thereby afford consumers a choice between competing pursuant to Section 526(c), 19 U.S.C. § 1526(c). See, e.g., Weil Ceramics and Glass, Inc. v. Dash, 878 F.2d 659, 666 (3d Cir.), cert. denied, 483 U.S. (1989).

78. Hahm, supra note 12, at 77.
79. Id.
80. Id. at 77-78.
81. See supra note 29 and accompanying text.
82. Hahm, supra note 12, at 78.
83. Trademark Act of 1946 (Lanham Act), 15 U.S.C. §§ 1051-1127 (1982). Congressman Fritz Lanham, after whom the Act was named, was the principal force behind the legislation.
84. S. REP. No. 1333, 79th Cong., 2d Sess. 3 (1946), reprinted in 1946 U.S.C.A.N. 1274, 1277 (hereinafter Senate Report). The Lanham Act § 45, defines a trademark to include:

any word, name, symbol, or device, or any combination thereof . . . used by a person . . . to identify and distinguish his or her goods, including a unique product, from those manufactured or sold by others and to indicate the source of the goods, even if that source is unknown.

15 U.S.C. § 1127. The term “mark” will be used interchangeably with trademark throughout this paper. Mark is a generic term, defined as a “trademark, service mark, collective mark, or certification mark.” Id.
85. Senate Report at 1274, 1277.
articles. Moreover, granting legal protection to safeguard the good reputation of the trademark was deemed necessary to encourage the owner to invest in maintaining the quality of the goods to which the trademark was associated. That Congress was persuaded by these virtues is manifested in its proclamation that "trade-marks should receive nationally the greatest protection that can be given them."

In economic terms, it may be said that trademarks perform an economizing function of reducing consumer search costs and require legal protection in order to be effective at the task. To be sure, the benefit of trademarks in reducing consumer search costs requires that the producer maintain consistent quality across consumer classes in order to preserve the reputation associated with the trademark. But the market will generally discipline the producer who fails to maintain quality by whittling away the distinctiveness of its trademark. That is, trademarks have a self-policing feature.

Thus, assuming the producer expends the necessary resources on quality, service and advertising, the reputation of the trademark will allow the producer to take advantage of the higher sales that flow from the willingness of consumers to pay higher prices in exchange for lower search costs and the assurance of consistent quality. The information capital embodied in the producer’s trademark good will depends, however, on the protection against free riding that it receives through the legal regime. In other words, if the law does not prevent it, free riding may weaken the strength of the trademark and reduce the producer's incentive to invest in the development of its good will.

The premium that trademark owners receive from protection, of course, will be eroded where his goods are forced to compete head to head with identical gray goods, in the absence of additional protection from such intrabrand competition. Some argue that, without such further protection, the premium will be diverted to the importer “and thus interfere with the functioning of the trademark system.” Perhaps the best response is that the premium still exists but is shared among the intrabrand competitors (or the common parent company) by natural market forces. In all cases, the debate rages on as to

86. Id. at 1275.
87. Id.
88. Id. at 1277.
90. Id. at 271-72.
91. Id. at 272.
whether absolute market exclusivity is a right of the trademark owner to be protected as a matter of trademark law.

A. Registration and Protection under the Lanham Act

If able to satisfy the statutory requirements, an applicant will be entitled to receive a registration certificate. Registration on the Principal Register affords the registrant a number of significant advantages under the Lanham Act. Principal among these are the ability to bar infringing imports under section 42 and to obtain statutory relief for infringement under section 32(a)(1). These remedial provisions will be discussed in turn.

1. Section 42

Section 42 of the Lanham Act prohibits the importation of goods bearing a mark that “copy or simulate” a registered trademark. The provision is identical, word for word, to section 27 of the Trademark Act of 1905 and is

93. Lanham Act §§ 1-2, 15 U.S.C. §§ 1051-52 (mark must be, for example, distinctive and not immoral, deceptive, scandalous or likely to cause confusion because it is similar to another mark). See generally 2 McCARTHY, supra note 2, §§ 19.1-19.56.
95. See JANE C. GINSBURG ET AL., TRADEMARK AND UNFAIR COMPETITION: CASES AND MATERIALS 277 (1991) (authors list a series of ten such advantages).
96. For unregistered trademarks, relief may be sought under section 43(a) of the Lanham Act, which provides an action for relief against common law trademark infringement as well as “any false designation of origin.” 15 U.S.C. § 1125(a)(1). As under sections 42 and 32(a)(1), the test for violation of this section is “likelihood of confusion.” See infra notes 105-08 and accompanying text.
97. Lanham Act § 42 provides in part:

no article of imported merchandise . . . 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 manufactured in the United States . . . shall be admitted to entry at any customhouse of the United States.

15 U.S.C. § 1124. Note that, unlike section 526 of the Tariff Act, this statute provides relief even where the registrant is not a domiciliary of the United States.
98. Trademark Act of 1905, ch. 592, § 7, 33 Stat. 730 (1905). Several early decisions held that this provision could not be used by a domestic owner to exclude genuine goods bearing the identical foreign trademark. See, e.g., Fred Gretsch Mfg. Co. v. Schoening, 238 F. 780, 781 (2d Cir. 1916) (“The obvious purpose [of section 27] is to protect the public and to prevent anyone from importing goods identified by their registered trade-mark which are not genuine.”). In a later case that followed Katzel, with the same operative facts, the Supreme Court summarily held that section 27 required the exclusion of genuine goods in view of its earlier decision. A. Bourjois v. Aldridge, 263 U.S. 675 (1923) (per curiam). Most courts have read this case to apply only to the Katzel situation and not as broad authority to exclude
understood to reenact the law as it existed up to the date of adoption. Trademark owners commonly rely on section 42 in tandem with other provisions to exclude gray market goods from the U.S. market, including sections 32 and 43 of the Lanham Act and section 526 of the Tariff Act.

In order to avail itself of the import ban created by section 42, the trademark owner must comply with regulations of the Customs Service, who enforces the statute. Customs regulations provide that an imported good bearing a mark that is likely to be confused with a federally registered mark is deemed to "copy or simulate" the registered mark. However, relief from such imports are subject to the same common control exception that applies to section 526.

2. Section 32(a)(1)

Section 32(a)(1) of the Lanham Act provides the owner of a registered trademark with an action against anyone who, without his consent, uses any "reproduction, counterfeit, copy, or colorable imitation" of the mark in a way that is "likely to cause confusion, or to cause mistake, or to deceive."

gray goods under section 42. See, e.g., Olympus Corp. v. United States, 792 F.2d 315, 321 (2d Cir. 1986). But see Lever Bros. Co. v. United States, 877 F.2d 101 (D.C. Cir. 1989) ("Aldridge reads § 27 to protect a domestic trademark holder from imports of trademarked merchandise that are 'genuine' abroad. . . .").


100. See, e.g., Olympus Corp., 792 F.2d at 320.

101. 2 McCarthy, supra note 2, § 29.11 (citing 19 C.F.R. § 133.0 et seq.). Note that if Customs authorities refuse to enforce sections 42 and 526, an action may be brought to compel their compliance. See, e.g., Lever Bros. Co. v. U.S., 877 F.2d 101 (D.C. Cir. 1989).

102. 19 C.F.R. § 133.21(a) provides in part:

Articles of foreign or domestic manufacture bearing a mark or name copying or simulating a recorded trademark or trade name shall be denied entry and are subject to forfeiture as prohibited importations. A "copying or simulating" mark or name is an actual counterfeit of the recorded mark or name or is one which so resembles it as to be likely to cause the public to associate the copying or simulating mark with the recorded mark or name.

(emphasis added). Professor McCarthy has noted that the emphasized language creates a test the same as that used to determine whether a federally registered mark has been infringed. 2 McCarthy, supra note 2, § 29.11.

103. See supra note 38. 19 C.F.R. § 133.21(c) is an exception that applies by its terms to both 19 C.F.R. §§ 133.21(a) and (b). In K Mart, 486 U.S. 281, 290 n.3 (1988), the Court did not reach the question of whether the common control exception was consistent with section 42.

104. Lanham Act § 32(a)(1) provides in part that any person who shall, without the consent of the registrant:
is recognized as the principal infringement section in the Lanham Act for registered trademarks.

"Likelihood of confusion" is the touchstone of trademark infringement, regardless of whether the owner’s right arise from state common law or under the Lanham Act. Likelihood of confusion may be proved by direct or circumstantial evidence. And each federal circuit court has developed a list of factors to be considered in determining infringement according to this standard.

Actual confusion as to the source of the goods is perhaps the strongest evidence that confusion is likely, but such proof is not required to establish infringement. Rather, it is sufficient that an appreciable number of ordinarily prudent purchasers are likely to be confused as to source, sponsorship or affiliation.

B. Actions to Exclude Gray Market Imports Under the Lanham Act

Some trademark owners have argued that Katzel sets forth a broad territorial principle that disallows parallel importation of identical foreign goods as a matter of right, i.e., without regard to its affiliation with the foreign

(a) use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive... shall be liable in a civil action by the registrant for the remedies hereinafter provided.


105. See 2 McCarthy, supra note 2, § 23.01.

106. E.g., the Second Circuit consistently follows an eight factor test introduced in Polaroid Corp. v. Polaroid Elec. Corp., 287 F.2d 492 (2d Cir.), cert. denied, 368 U.S. 820 (1961), which includes consideration of:

(1) the strength of the senior user’s mark;
(2) the degree of similarity between the conflicting marks;
(3) the proximity of the goods or services;
(4) the likelihood that the senior user will bridge the gap between the goods or services of the parties;
(5) evidence of actual consumer confusion;
(6) the junior user’s good faith in choosing its mark;
(7) the quality of the junior user’s product; and
(8) the sophistication of the buyers.

Id. at 495.

107. See, e.g., World Carpets, Inc. v. Dick Littrell’s New World Carpets, 438 F.2d 482, 489 (5th Cir. 1971).


109. See supra notes 22-31 and accompanying text.
Courts generally reject that view of the decision, and refuse to attribute the same to the Lanham Act. Instead, the U.S. trademark owner must first establish local goodwill connected with the mark, i.e., consumers perceive it as a source independent of its foreign affiliated source. Absent such proof, the trademark right should be deemed exhausted upon the first sale of the branded good. Under this "exhaustion" or "first sale" doctrine, as applied within the borders of a sovereign, a mark holder may no longer control goods bearing a genuine trademark after they enter the stream of commerce.

That is not to say, however, that proof of independent goodwill alone is sufficient to entitle the domestic trademark owner to exclude gray goods from affiliates under sections 42 and 32. Rather, the mark holder must also demonstrate that the gray goods are "materially different" from those authorized.


111. See id. at 668-69 where the court states:

We do not read the Lanham Act . . . to protect a foreign manufacturer — that either owns or is owned by a domestic trademark holder — from competition in the sale of its product in the United States by a domestic importer that it has supplied . . .

In our view, the Court's conclusion in Katzel does not represent the establishment of a broad "territoriality theory" applicable to every instance in which a domestic company acquires the United States trademark for a foreign manufactured good.


112. See, e.g., Osawa & Co., 589 F. Supp. at 1174. See generally 2 LADAS, supra note 21, § 737.

113. See 2 LADAS, supra note 21, § 732.

114. E.g., NEC Elecs. v. CAL Circuit Abco, 810 F.2d 1506, 1509 (9th Cir.) ("Once a trademark owner sells his product, the buyer ordinarily may resell the product under the original mark without incurring any trademark law liability."). cert. denied, 484 U.S. 851 (1987). This doctrine has limitations in the international context because Article 6(3) of the Paris Convention and section 44(f) of the Lanham Act recognize that trademark rights are national in character and exist independent of each other. See Weil Ceramics, 878 F.2d at 679 (J. Becker, concurring). Thus, domestic trademark rights associated with goods emanating from a foreign affiliate are forfeited only where the owner is unable to establish independent goodwill. See Original Appalachian Artworks, Inc. v. Granada Elecs., Inc., 816 F.2d 68, 76 (2d Cir.), cert. denied, 484 U.S. 847 (1987) (J. Cardamone, concurring); see also Osawa & Co., 589 F. Supp. at 1174 ("If the U.S. mark represents nothing more than a foreign outpost
for domestic distribution. A dichotomy has thus developed for distinguishing between gray goods that are identical to those authorized for sale by the trademark owner (which may not be excluded from the U.S. market as a matter of trademark law) and gray goods that are materially different (which may be banned).

This dichotomy can be illustrated by considering several key cases coming out of the various federal circuits. First, in *Weil Ceramics and Glass, Inc. v. Dash,* the Third Circuit was asked to decide whether section 32 and 42 relief were available to a domestic holder of the mark LLADRO for porcelain against the importer of identical gray goods. The foreign producer and the U.S. mark holder (and exclusive U.S. distributor) were subsidiaries of a common parent, a family owned corporation in Spain. Defendant obtained genuine LLADRO porcelain through distributors of the producer and imported the same into the U.S. for resale. The trial court awarded the trademark owner summary judgment under both provisions, concluding that the identical goods were likely to cause confusion because independent good will in the LLADRO mark had been established.

On appeal, the Third Circuit reversed the lower court ruling. After concluding that *Katzel* did not apply because of the affiliation between the mark holder and the foreign producer, the court construed the language “copy or simulate” of section 42 and “reproduction, counterfeit, copy or colorable simulation” of section 32(a)(1). The *Weil Ceramics* court held that:

> In our view, the language of these sections reflects Congress’ intent to provide a remedy only to the domestic trademark holder who is injured by the distribution of like goods, which bear facsimile marks, that result in confusion to consumers or detriment to the goodwill developed by the trademark holder in the trademarked goods. “Trademark law generally

of the goodwill associated with the original mark, it might well be argued that exhaustion has taken place with the release into commerce and that no infringement occurs on unauthorized importation.”

115. See, e.g., *Original Appalachian Artworks,* 816 F.2d at 73.
117. The cases discussed herein represent, in the author’s view, the most significant discussions of trademark doctrine relating to the gray market good problem.
119. Id. at 661.
120. Id. at 662 n.2.
121. Id. at 663-64.
122. Id. at 668-89.
123. Id. at 670.
does not reach the sale of genuine goods bearing a true mark even though such sale is without the owner’s consent." \(^{124}\)

It found further support for this conclusion in the policies underlying the Lanham Act, namely protection of the trademark holder’s goodwill and against consumer deception. \(^{125}\) The court properly observed that neither of these policies were frustrated by the importation of identical goods because consumers were getting what they believed they were purchasing and, as a result, no adverse association would exist to damage plaintiff’s goodwill. \(^{126}\)

As to the free rider problem, the court observed

That loss to Weil is not inconsequential or insignificant. The remedy for it, however, is not properly found in the trademark law, particularly not in this case. Moreover, as we noted earlier, that “injury” is not completely uncompensated because plaintiff’s parent corporation profits by the sale of Jalyn [sic, LLADRO] abroad. \(^{127}\)

In sum, the *Weil Ceramics* court decided that the protection recognized in *Katzel* should not be further extended to the situation in which the trademark owner and the manufacturer are part of the same multinational enterprise. \(^{128}\)

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124. *Id.* at 671 (quoting NEC Elecs v. CAL Circuit Abco, 810 F.2d 1506, 1509 (9th Cir.), cert. denied, 484 U.S. 851 (1987) (citations omitted)). In *NEC*, plaintiff, a wholly owned subsidiary of a Japanese computer chip producer, sought to enjoin parallel importation of identical chips by defendant. In denying such relief under section 32, the court stated:

If [the parent] chooses to sell abroad at lower prices than those it could obtain for the identical product here, that is its business. In doing so, however, it cannot look to the 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 [the parent] 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.

*NEC Elecs*, 810 F.2d at 1511.


126. *Id.* at 672.

127. *Id.*

128. *Id.* at 674. Although disagreeing with the majority’s reading of *Katzel*, Judge Becker (concurring) concluded that no relief was available because plaintiff’s parent company ignored self-help remedies and in effect “engineered the possibility of a likelihood of confusion,” an injury not protected against under the Lanham Act. *Id.* at 676. More particularly, he stated that

I would hold that a wholly owned subsidiary and its parent have, as the Supreme Court in *Copperweld* stated, “a complete unity of interest.” 467 U.S. [752] at 771, 104 S.Ct. at 2741. I therefore believe that the injury here is self-inflicted and that likelihood of confusion has not been established as that phrase was intended under the Lanham Act. To protect [plaintiff’s] interest in its American trademark, [plaintiff’s] parent, Lladro, could affix different trademarks to each corresponding level of quality, different trademarks to those products imported into the United
The Third Circuit's decision, however, lost some of its force shortly after its release, when the District of Columbia decided *Lever Bros. Co. v. United States*. There, the trademark owner sought to enjoin the importation of SHIELD soap and SUNLIGHT dishwashing detergent produced abroad by a foreign affiliate for the British market. But in this case, a suit against the Customs Service for refusing to exclude the goods under section 42, the trademark owner introduced evidence that the goods produced abroad contained different ingredients and possessed different qualities than those produced for the domestic market. In particular, the plaintiff demonstrated that the British SHIELD soap was manufactured to lather less quickly than the U.S. version due to the British preference for baths over showers, which Americans prefer. Moreover, evidence was offered to show that British SUNLIGHT detergent was designed for use in hard water and did not perform as well in soft water typical in the United States. The plaintiff asserted that these differences justified banning the gray goods, and that application of the affiliation exception in this context violates section 42. Conversely, Customs asserted that the affiliate exception applied without regard to the physical differences, the premise being that related companies are constructively one for purposes of trademark infringement. The trial court agreed with this interpretation and denied the plaintiff's motion for a preliminary injunction to enjoin the application of the affiliate exception.

On appeal, the D.C. Circuit reversed the District Court decree. The court first found case support for drawing a distinction under section 42

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*Id.* at 683.


130. *Id.* at 102.

131. *Id.*

132. *Id.* at 103.

133. *Id.*

134. See *supra* note 102 and accompanying text.

135. *Lever Bros.*, 877 F.2d at 104.

136. *Id.*

137. *Id.* at 105. The court, however, stated that its conclusions were provisional because the parties had not joined issue on the legislative history and Customs administration interpretation of section 42 in any detail.

138. The court placed particular reliance upon *Original Appalachian Artworks v. Granada Elec., Inc.*, 816 F.2d 68 (2nd Cir.), *cert. denied*, 484 U.S. 847 (1987), a *K Mart Case 3* decision. There, the owner of the registered trademark CABBAGE PATCH KIDS for dolls sued an importer of very similar goods (except for having Spanish rather than English birth certificates, adoption papers and instructions) bearing the trademark, manufactured in Spain.
between identical goods and physically different goods. The court also rejected the Government’s proffered justifications for the exception, namely that trademark infringement required distinct interests, that self-help was a less restrictive alternative to an important ban, and that the ban was driven by administrative necessity. It thus tentatively concluded that

[T]he natural, virtually inevitable reading of [section] 42 is that it bars foreign goods bearing a trademark identical to a valid US trademark but physically different, regardless of the trademarks’ genuine character abroad or affiliation between the producing firms. On its face the section appears to aim at deceit and consumer confusion; when identical trademarks have acquired different meanings in different countries, one who imports the foreign version to sell it under that trademark will (in the absence of some specially differentiating feature) cause the confusion Congress sought to avoid. The fact of affiliation between the producers in no way reduces the probability of that confusion; it is certainly not a constructive consent to the importation. The cases are entirely congruent with this view. Customs’ assertion of administrative difficulties appears overdrawn, and in any event would seem to justify no more than inaction in those cases that are close on the factual issue of product identity. Thus, despite the deference we owe Customs under Chevron, we believe that the affiliate exception does not square with [section] 42.

Judicial recognition of the identical goods-materially different goods dichotomy further crystallized in Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., a recent K Mart Case decision from the First Circuit. There the trademark owner, Nestle, sought relief under sections 32, 42 and 43(a) of the Lanham Act for the unauthorized importation into Puerto Rico of PERUGINA chocolates. After being terminated as the local distributor of Nestle’s Italian-made chocolates, defendant commenced importing Venezu-
elan-made PERUGINA chocolates, produced by a third party under a license from Nestle. Nestle argued that material differences including presentation, variety, and composition threatened to erode the goodwill connected with the PERUGINA mark, which local consumers associated with Italian-made chocolates. Having been denied relief by the trial court, Nestle appealed the ruling to the First Circuit, which reversed the lower court decree.

At the outset, the court held that liability for each Lanham Act claim for gray good infringement "necessarily turns on the existence vel non of material differences between the products of a sort likely to create consumer confusion." In fashioning the appropriate materiality standard, the court set out guidelines for lower courts to follow. First, where the goods are identical, the action cannot be sustained because consumers receive what they bargained for and damage to the domestic distributor's goodwill is not cognizable. Similarly, reasoned the court, no violation of the Act will arise from the sale of patently different products based on its assumption that consumer confusion or injury to goodwill is highly unlikely. The gray area, according to the court, is where similarities are strong and thus the risk of confusion greatest. With this in mind, the court said:

We conclude that the existence of any difference between the registrant's product and the allegedly infringing gray good that consumers would likely consider to be relevant when purchasing a product creates a presumption of consumer confusion sufficient to support a Lanham Trade-Mark Act claim. Any higher threshold would endanger a manufacturer's investment in product goodwill and unduly subject consumers to potential confusion by severing the tie between a manufacturer's protected mark and its associated bundle of traits.

Applying this standard to the facts, the court concluded that several material differences existed and defendant had not successfully rebutted the presumption of confusion created thereby. More specifically, the court found physical differences in the Venezuelan-made PERUGINA chocolates
that it deemed material to the purchasing decision, including a comparatively short shelflife, limited variety of shapes and packaging that was less elegant than the authorized Italian-made chocolates. Moreover, the court also found certain non-physical differences, including quality control and price, to be material and thus likely to cause consumer confusion.\textsuperscript{155}

This expansive approach to determining material differences manifestly narrows the category of identical goods cases for which no relief is available to the domestic mark holder.\textsuperscript{156} While the Nestle court’s consideration of physical differences between the respective products is in accord with Lever Bros. and strikes a sensible balance among competing interests, the same cannot be said with respect to non-physical differences. Indeed, other courts have refused to give any weight to these factors,\textsuperscript{157} and doing so significantly shifts the boundary between gray goods that infringe and those that do not. My view, explained in more detail below, is that the approach in Nestle of considering factors that do not relate to the physical quality of the goods, at least where the domestic mark holder and foreign producer are related, unduly subordinates the interests of consumers and competition to that of trademark owners.

IV. THE GRAY MARKET – NOW AND BEYOND

With the common control exception to section 526 secure,\textsuperscript{158} the battle ground for trademark owners and gray market importers is whether dissimilarities between the domestic and gray market goods represent material differences under the Lanham Act. This dichotomy in effect operates as a means by which to control the territorial scope of trademark rights. When drawn in such a way that only physically significant differences in the product are

\textsuperscript{155} \textit{Id.} at 642-44. Significantly, the court stated earlier in the opinion that:

\begin{quote}
We think the appropriate test \textit{should not be strictly limited to physical differences}. Other sorts of differences—differences in, say, warranty protection or service commitments—may well render products non-identical in the relevant Lanham Trade-Mark Act sense.
\end{quote}

\textit{Id.} at 639 n.7 (citations omitted) (emphasis added).


\textsuperscript{157} \textit{See}, e.g., NEC Elecs, 810 F.2d at 1511 (price difference not material); Bell & Howell: Mamiya Co. v. Masel Supply Co., 719 F.2d 42, 46 (2d Cir. 1983) (warranty difference not material where less restrictive means exist to abrogate confusion); Parfums Stern, Inc. v. United States, 575 F. Supp. 416, 421 (S.D. Fla. 1983) (same); Mavic, Inc. v. Sinclair Imports, Inc., No. 93-2444, 1994 WL 7703 at *3 (E.D. Pa. Jan. 12, 1994) (price, inspection, service and customer support differences not material).

\textsuperscript{158} \textit{See supra} notes 67-73 and accompanying text.
deemed to cause a likelihood of confusion, the market for the multinational enterprise assumes a global character and it is unable to geographically divide the market by use of the trademark right. This, of course, advances consumer interests and promotes competition but may impair the trademark owner’s ability to achieve a return on its investment in the goodwill associated with the mark under which the domestic good is sold. But, as noted above, self-help measures are available to the trademark owner, including using different marks for goods of varying quality or otherwise normalizing quality, abandoning discriminatory pricing policies, refusing to deal with traders who divert the goods to the U.S. market, and imposing territorial restrictions in agreements with distributors.

Alternatively, where the inquiry considers physical differences as well as non-physical differences associated with the good or its distribution, the product market appears more national in character by virtue of the trademark owner’s enhanced ability to exclude competing gray goods. This approach more readily enables the trademark owner to eliminate free riding and fully capture any premium associated with lower consumer search costs, thus encouraging investment in developing the goodwill identified with the mark. The adverse side effect of the analysis is, of course, that consumers are forced to pay the premium and are denied alternative sources of supply that offer different terms of sale or services.

Some argue that this approach, or even a per se rule of exclusion, is preferable because it is efficient to administer and because the threat posed to the goodwill of the mark is greater than the risk of price discrimination.159 Indeed, Senator Hatch has proposed a bill that would amend the Lanham Act to prohibit all gray market goods from entering the U.S. market without the consent of the trademark owner, regardless of any affiliation between the trademark owner and foreign producer.160 Although Congress has yet to enact it into law, the legislation undoubtedly has the support of trademark owners and many members of the bar.161

Although the proposition that preventing intrabrand competition raises anticompetitive concerns only where interbrand competition is not present is sound, it simply does not answer whether prohibiting such competition is compelled by the trademark law. The Lanham Act in fact serves different purposes. It seeks to both protect consumers from exposure to confusingly similar marks and safeguard the goodwill associated with the mark. That is,

159. See Miller, supra note 4, at 388.
the outright prevention of free riding is not per se found among the declared purposes of the Act.

Trademark law protects the domestic mark holder from gray market competition where the source is an affiliated producer only where the unauthorized goods create a likelihood of confusion in the marketplace. As part of its proof, the domestic trademark owner must first establish local goodwill from the perspective of consumers. If unable to do so, the trademark right should be deemed exhausted upon release into the stream of commerce. Such a rule strikes a proper balance between protecting the legitimate interests of trademark owners, competition and of consumers. It also constitutes a recognition that a ban of these gray goods "provides extraordinary protection to certain holders of trademarks registered in the United States."165

To be sure, material differences between the domestic and gray goods, such as quality or ingredients, is evidence that the goodwill in the domestic owner is distinct from that of the foreign producer. But differences, to be material, should bear some direct relation to the goodwill embodied in the mark. Any other rule would permit the material difference exception to "swallow the rule."167

On the other hand, differences in the terms of sale, such as price and warranty, as well as pre-sale and post-sale services are simply not sufficiently related to the goodwill associated with the mark to support an inference of a likelihood of confusion. These differences are well recognized means by

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162. An affiliated foreign producer is one that is a parent, division, or majority owned subsidiary of the domestic trademark owner but would not include a licensee or other independent entity.

163. See supra text accompanying note 112.

164. One commentator has noted other limitations imposed on the right to control the distribution of branded goods:

[A] trademark owner cannot halt the sale of "distress" merchandise at low prices, cannot stop sales of damaged or used goods if those facts are disclosed and cannot enjoin a seller merely because he does not like the seller's resale practices. Dealer termination is generally an option available to the markholder in these scenarios, but an injunction against such sales is usually not available.

Lipner, supra note 116, at 1047-48 (footnotes and citations omitted).

165. K Mart, 486 U.S. at 295 (Brennan, J., concurring).

166. RESTATEMENT, supra note 2, § 24, cmt. f.


168. I am not yet prepared to offer this same solution for the K Mart Case 3 scenario — i.e., where the foreign producer is a licensee of the domestic trademark holder. My initial reaction is that the equities are different, particularly since control over quality may be in the hands of an independent enterprise. At least one court has recognized that this distinction justifies different treatment. See El Greco Leather Prods. Co v. Shoe World, Inc., 806 F.2d
which to differentiate one's product in the marketplace, and any confusion or
deception that may result in damage to the goodwill of the domestic owner's
mark from these differences may be prevented through self help or other
legal remedies that have a less drastic effect on competition than an outright
ban of the gray good. Moreover, the restriction suggested also has the
effect of preventing the expansion of the territoriality principle, a doctrine
that, according to the courts, is not without boundaries.

V. CONCLUSION

The Supreme Court's decision in \textit{K Mart} did little to resolve the gray
market controversy. In the wake of the decision, trademark owners with for-

ground affiliates who produce gray goods, having lost in their attempt to inval-
date the common control exception to section 526, are now fighting the battle
against these competing goods under the Lanham Act. This trademark regime
is designed to protect consumers against confusion and to safeguard the good-
will embodied in trademarks and the investment therein. But, it is not per se
a system designed to protect the trademark owner from the intrabrand com-
petition faced when genuine imports produced abroad by an affiliated enter-
prise are imported into the U.S. market. Rather, it prohibits these gray goods
from entering the U.S. market only where the mark owner can demonstrate
independent goodwill embodied in the mark and that asserted differences are
indeed likely to cause confusion. And in order not to undermine the poten-
tial benefits to consumers from the competition of gray market goods, the
trademark owner must demonstrate a clear nexus between the difference as-
serted as material and the goodwill connected with the mark. Absent this
direct relationship, the distinction should be disregarded in the infringement
analysis.

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392 (2d Cir. 1986) (enjoined sale of gray goods produced by foreign licensee not shown to be
of inferior quality because licensor had no control over quality), \textit{cert. denied}, 484 U.S. 817
(1987). If, however, it can be shown that the licensor has the right to control the quality and
distribution of the goods, there is no compelling reason to adopt a different standard. (But,
even under these circumstances, the trademark owner may obtain relief under section 526).
There was no such evidence introduced in either \textit{Nestle} or \textit{Appalachian Artworks, supra}
notes 138 & 146 and accompanying text.

169. \textit{See}, e.g., \textit{NEC Ecles.}, 810 F.2d at 1510 (tort of deceit or unfair competition); \textit{Bell &
Howell}, 719 F.2d at 46 (labelling law).

170. \textit{See supra} notes 110-11 and accompanying text.