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NOTE

K Mart Corp. v. Cartier, Inc.: Limiting the Protection of Section 526 of the Tariff Act of 1930

The rapid increase in gray market importation¹ has resulted in considerable litigation and controversy over the appropriate interpretation of section 526 of the Tariff Act of 1930.² Gray market goods are goods manufactured abroad bearing a genuine foreign trademark that is identical to the U.S. trademark.³ These goods are sold legitimately overseas by the foreign manufacturer and ulti-

¹ Estimated sales of gray market goods over the past few years are \$5.5 to \$10 billion annually. See Kersner & 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, 251 (1986). See also Feder, "Gray Market" Grew With Rise of Dollar, N.Y. Times, Dec. 9, 1986, at D4, col. 2 (estimating gray market sales as \$5 to \$7 billion per year). The strength of the U.S. dollar overseas increased the gray market industry in the early and mid-1980s. See Comment, *The Gray Market Controversy and the Court: Analysis of Conflicting Court of Appeals Decisions on the Validity of Customs Regulations Permitting Unauthorized Third Party Importation of Trademarked Goods*, 18 SETON HALL L. REV. 55, 58 (1988).

² 19 U.S.C. § 1526 (1982). This was originally enacted in the Tariff Act of 1922 and then reenacted unchanged in the Tariff Act of 1930. Tariff Act of 1922, Pub. L. No. 67-318, 42 Stat. 858 (1922); Tariff Act of 1930, Pub. L. No. 71-361, 46 Stat. 590 (1930). Section 1526 provides:

(a) Except as provided in subsection (d) of this section, 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, under the provisions of sections 81 to 109 of title 15, and if a copy of the certificate of registration of such trademark is filed with the Secretary of the Treasury, in the manner provided in section 106 of said title 15, unless written consent of the owner of such trademark is produced at the time of making entry.

(b) Any such merchandise imported into the United States in violation of the provisions of this section shall be subject to seizure and forfeiture for violation of the customs laws.

19 U.S.C. § 1526 (1982).

³ *K Mart Corp. v. Cartier, Inc.*, — U.S. —, 108 S. Ct. 1811, 1814-15 (1988). Well-known products such as Dial soap, Seiko, Rolex and Citizen watches, Sony, Panasonic and Maxell electronic goods, Colgate toothpaste, Duracell batteries, Kodak film, and Michelin tires are a few of the goods susceptible to gray marketeers. Comment, *supra* note 1, at 57 n.6 (quoting Comments of The Coalition to Preserve the Integrity of Am. Trademarks, at App. A, 1 (Oct. 20, 1986)); *In re Importations Bearing Recorded U.S. Trademarks*, Solicitation of Public Comment on Gray Market Policy Opinions, 51 Fed. Reg. 22,005 (1986) (U.S. Customs Serv. Treas. Dep't).

mately imported into the United States by third parties.⁴ This importation occurs without the U.S. trademark owner's permission.⁵ Neither the Customs Service⁶ nor the courts have consistently implemented or enforced a policy to protect U.S. trademark owners from the strong intrabrand competition that results from parallel gray market importation.⁷

The Customs Service has incorporated section 526 into its regulations by denying entry to imports that bear a recorded trademark or tradename.⁸ The regulations provide exceptions that allow im-

⁴ *K Mart Corp.*, 108 S. Ct. at 1814-15. A gray market arises when a price difference between two markets allows an arbitrageur to take advantage of this difference by buying in the market when prices are lower and selling in the market when prices are higher. *W. Goebel Porzellanfabrik v. Action Indus., Inc.*, 589 F. Supp. 763, 764 n.1 (S.D.N.Y. 1984). Importers of gray goods believe that the gray market develops as a result of different affiliates of a manufacturer being able to sell at different prices the same trademarked item at any given point in time. See Comment, *supra* note 1, at 58 n.7.

⁵ *K Mart Corp.*, 108 S. Ct. at 1814-15. Trademark owners often refer to this type of importation as "parallel importation." *Id.* Some courts and commentators, however, believe that parallel importation technically implies a more specific type of gray market importation in which the U.S. trademark owner is the actual importer of the same goods. *Vivitar Corp. v. United States*, 761 F.2d 1552, 1555 (Fed. Cir. 1985). See Hansen, *Gray Market Goods: A Lighter Shade of Black*, 13 BROOKLYN J. INT'L L. 249, 249 n.3 (1987).

⁶ The Customs Service is the administrative agency from the Department of the Treasury that regulates merchandise importation. 19 U.S.C. § 1624 (1982).

⁷ See Atwood, *Import Restrictions on Trademarked Merchandise—The Role of the United States Bureau of Customs*, 59 TRADEMARK REP. 301, 301-09 (1969). Because gray market goods are purchased abroad at a discount they can be sold in the United States at a price significantly lower than the U.S. trademarked goods. See Mackintosh, *Grey Market Imports: Burgeoning Crisis or Emerging Policy*, 11 N.C.J. INT'L L. & COM. REG. 283, 285 (1986). One theory for the price discrepancy relies on the fluctuating currency rates and the strength of the U.S. dollar overseas. See Comment, *supra* note 1, at 58. Another possibility for the lower price of gray goods is the benefit that gray marketeers receive from the advertising, promotion, and warranty servicing of the U.S. trademark owner. *Id.* The gray marketeers need to advertise only their lower price. See also Note, *The Greying of American Trademarks: The Genuine Goods Exclusion Act and The Incongruity of Customs Regulation* 19 C.F.R. § 133.21, 54 FORDHAM L. REV. 83, 86 n.9 (1985) (citing *Osawa & Co. v. B & H Photo*, 589 F. Supp. 1163, 1167 (S.D.N.Y. 1984)). Because of this lucrative gray market, U.S. trademark owners are losing market share and profits. *Id.* at 84. Gray market opponents maintain that continued importation of these goods will destroy the trademark's property value by allowing third parties to obtain a free ride on the products' goodwill. See Kelly, *An Overview of the Influx of Gray Market Goods Into the United States*, 11 N.C.J. INT'L L. & COM. REG. 231, 231-32 (1986).

⁸ The Custom Service regulation states:

§ 133.21 Restrictions on importation of articles bearing recorded trademarks and trade names.

(a) *Copying or simulating marks or names.* Articles of foreign or domestic manufacture bearing a mark or name copying or simulating a recorded trademark or tradename 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.

(b) *Identical trademark.* 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 with in the United States are subject to seizure and forfeiture as prohibited importations.

19 C.F.R. § 133.21(a)-(b) (1988).

ports of unauthorized trademarked goods if either the foreign supplier and the U.S. trademark owner are affiliated companies or part of the same company, or if the imported articles are manufactured with the authorization of the U.S. trademark owner.⁹ The former situation is known as the common-control exception, while the latter is referred to as the authorized-use exception.¹⁰ Over the years judges and commentators have disagreed over the validity of the regulations.¹¹ The U.S. Supreme Court in *K Mart Corp. v. Cartier, Inc.*¹² resolved the controversy and held that the common-control exception¹³ was a consistent interpretation of section 526.¹⁴ The Court further held that the authorized-use exception¹⁵ was invalid and concluded that goods made in a foreign country by an independent foreign manufacturer could not be removed from the scope of section 526.¹⁶ This Note examines the rationale behind the Court's decision in *K Mart Corp.*, the development of trademark law as it pertains to gray market goods, and the possible ramifications of the decision on U.S. industry.

In *K Mart Corp.* the Coalition to Preserve the Integrity of American Trademarks (COPIAT) brought suit against the United States, the Commissioner of Customs, and the Secretary of the Treasury, seeking a declaration to invalidate the common-control and authorized-use exceptions as inconsistent with section 526 of the Tariff Act and an injunction against its enforcement.¹⁷ COPIAT is a trade association of U.S. companies that own registered U.S. trademarks. Two of its members, Cartier, Inc. and Charles of the Ritz Group Ltd., joined in the suit. *K Mart Corp.* and 47th Street Photo inter-

⁹ The relevant portion of section 133.21(c) provides:

(c) *Restrictions not applicable.* The restrictions set forth in paragraphs (a) and (b) of this section do not apply to imported articles when:

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

(2) The foreign and domestic trademark or trade name owners are parent and subsidiary companies or are otherwise subject to common ownership or control (see §§ 133.2(d) and 133.12(d));

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

19 C.F.R. § 133.21(c)(1)-(3) (1988).

¹⁰ *Id.*

¹¹ See *Coalition to Preserve the Integrity of Am. Trademarks v. United States (COPIAT)*, 790 F.2d 903, 904-05 (D.C. Cir. 1986) (rejecting the regulation as inconsistent with section 526); *Olympus Corp. v. United States*, 792 F.2d 315, 316 (2d Cir. 1986) (upholding the regulation); *Vivitar Corp. v. United States*, 761 F.2d 1552 (Fed. Cir. 1985) (upholding the regulation as consistent with section 526).

¹² 108 S. Ct. 1811 (1988).

¹³ 19 C.F.R. § 133.21(c)(1)-(2) (1988).

¹⁴ *K Mart Corp.*, 108 S. Ct. at 1817-18.

¹⁵ 19 C.F.R. § 133.21(c)(3) (1988).

¹⁶ *K Mart Corp.*, 108 S. Ct. at 1818-19.

¹⁷ *Id.* at 1816-17.

vened as defendants.¹⁸ The district court upheld the regulation as a sufficiently reasonable interpretation of the statute.¹⁹ The D.C. Circuit Court of Appeals reversed the district court²⁰ and concluded that the regulation was an unreasonable administrative interpretation of section 526.²¹ The U.S. Supreme Court granted certiorari to consider whether the Customs Service regulation is consistent with section 526.

In analyzing the validity of the Customs regulation, the Court considered three distinct commercial relationships between U.S. trademark holders and foreign manufacturers.²² First, the Court discussed the typical gray market situation.²³ There, a domestic firm purchases from an independent foreign company the right to use its trademark in the sale of its goods.²⁴ When a foreign firm sells some of its goods bearing the trademark abroad to a third party who subsequently imports them into the U.S. for resale, these imported goods become gray-market goods that compete with the U.S. trademarked goods.²⁵

Second, the Court discussed the gray market situation that involves a domestic firm with a registered U.S. trademark for goods manufactured abroad by an affiliated manufacturer.²⁶ The gray market develops when a third party purchases the goods abroad and imports them into the United States.²⁷ There are three variations to this gray market situation.²⁸ The first variation occurs when the foreign manufacturer attempts to control distribution in the United States by establishing a subsidiary.²⁹ Other gray market instances

¹⁸ *Coalition to Preserve the Integrity of Am. Trademarks v. United States*, 790 F.2d 903, 904 (D.C. Cir. 1986).

¹⁹ *Coalition to Preserve the Integrity of Am. Trademarks v. United States*, 598 F. Supp. 844, 851 (D.D.C. 1984).

²⁰ *See id.* In its analysis, the court looked to the legislative history, judicial decisions, legislative acquiescence, and the long-standing policy of the Customs Service. *Id.* at 852.

²¹ *COPIAT*, 790 F.2d at 916-17.

²² *K Mart Corp. v. Cartier, Inc.*, — U.S. —, 108 S. Ct. 1811, 1814-15 (1988). The possible combinations encountered on the gray market are many and varied.

For example, the U.S. and foreign trademark rights may be owned by the same entity or by related companies, or by wholly separate companies. The goods of the U.S. owner may be imported and may be identical to, or different from, the parallel import. Goods may be produced in the U.S. by the U.S. trademark owner and different goods produced abroad by the U.S. owner or its affiliate. Services and warranties may or may not be the same as abroad. A foreign licensee (i.e., related company) may be required by foreign law and may not be subject to meaningful control by the U.S. owner.

Vivitar Corp. v. United States, 761 F.2d 1552, 1570 n.24 (Fed. Cir. 1985).

²³ *K Mart Corp.*, 108 S. Ct. at 1814-15.

²⁴ *Id.* The U.S. Supreme Court referred to this relationship as a "case 1" gray market.

²⁵ *Id.*

²⁶ *Id.* at 1815. The Court referred to this relationship as a "case 2" gray market.

²⁷ *Id.*

²⁸ *Id.* These variations are often labeled "case 2a," "case 2b," and "case 2c."

²⁹ *Id.*

arise when an U.S. company establishes a manufacturing subsidiary abroad or owns an unincorporated manufacturing division overseas.³⁰

In the third context, a domestic trademark holder authorizes an independent foreign firm to use its trademark, usually selling the company the exclusive rights for distribution in a particular foreign area.³¹ When a foreign firm or a third party imports the goods into the United States, a gray market results.³²

In its analysis, the Court first determined whether the regulation was consistent with the language of section 526.³³ The Court noted precedent which stated that if a regulation was not in conflict with the plain language of the statute, "a reviewing court must give deference to the agency's interpretation of the statute."³⁴ All nine Justices agreed that section 526 bars importation of gray market goods when a U.S. firm purchases the rights to the trademark from an independent foreign manufacturer.³⁵ In addition, the Court concluded that the Customs Service regulation providing for a common-control exception³⁶ is a permissible construction of the statute.³⁷

³⁰ *Id.*

³¹ *Id.* This situation is referred to as "case 3."

³² *Id.*

³³ *Id.* at 1817.

³⁴ *Id.* at 1817 (citing *United States v. Boyle*, 469 U.S. 241, 246 n.4 (1985)). The U.S. Supreme Court elaborated on the rules of statutory construction in *Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc.* *Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837 (1984). The *Chevron* Court formulated a two part analysis for reviewing an agency's construction of a statute it administers. *Id.* at 842. First, the court must determine if Congress has directly addressed the question at issue. If the congressional intent is clear, then the court and the agency must give effect to the unambiguously expressed intent of Congress. *Id.* at 843. According to the Court: "The judiciary is the final authority on issues of statutory construction and must reject administrative constructions which are contrary to clear congressional intent." *Id.* at 843 n.9. See also *FEC v. Democratic Senatorial Campaign Comm.*, 454 U.S. 27, 32 (1981); *SEC v. Sloan*, 436 U.S. 103, 117-18 (1978); *FMC v. Seatrain Lines, Inc.*, 411 U.S. 726, 745-46 (1973). If, on the other hand, the Court decided that Congress has not directly addressed the question or is ambiguous as to the meaning then there is an implicit legislative delegation to the agency regarding the particular question. *Chevron*, 467 U.S. at 844. For an agency to administer effectively a congressionally created program it must be able to formulate policy and regulations to fill any gap left by Congress. *Morton v. Ruiz*, 415 U.S. 199, 231 (1974).

When the court determines that the statute is silent or ambiguous with respect to an issue addressed by the regulation, the court employs the second part of the statutory construction analysis. The standard of review in this step is exceedingly deferential. Note, *A Framework for Judicial Review of an Agency Statutory Interpretation: Chevron U.S.A. v. Natural Resources Defense Council*, 1985 DUKE L.J. 469, 478. The court must uphold the agency interpretation if it is "based on a permissible construction of the statute." *Chevron*, 467 U.S. at 845.

³⁵ *K Mart Corp. v. Cartier, Inc.*, — U.S. —, 108 S. Ct. 1811, 1818 (1988). This is the case 1 situation and was first settled in *A. Bourjois & Co. v. Katzel*. See note 74 *infra* & accompanying text.

³⁶ 19 C.F.R. § 133.21(c)(1)-(2) (1988).

³⁷ *K Mart Corp.*, 108 S. Ct. at 1817-18. Justice Kennedy, Justice White, Justice Brennan, Justice Marshall, and Justice Stevens agreed to uphold the common-control exception. Justice Kennedy, with the concurrence of Justice White, concluded that the

The Court stated that the meaning of "owned by"³⁸ was unclear and, therefore it was permissible for the Customs Service to construe "owned by" to apply to instances involving a foreign parent.³⁹ Confusion over ownership existed because of the difficulty in distinguishing which entity actually owned the trademark—the U.S. firm as a subsidiary or the foreign parent.⁴⁰ The Court further ruled that the phrase "merchandise of foreign manufacture" was sufficiently ambiguous to uphold the agency's interpretation of the regulation as it applied in some gray market situations.⁴¹ According to Justice Kennedy, the agency may reasonably interpret the phrase "of foreign manufacture" as not applying to goods manufactured by foreign subsidiary or division of a domestic company because of the ambiguous wording of the statute.⁴² As a result, the Court upheld the common-control exception.⁴³

In a separate opinion, Justice Brennan elaborated on the policy

regulation is a "permissible construction designed to resolve statutory ambiguities." *Id.* at 1818.

³⁸ 19 U.S.C. § 1526 (1982). For the full text of section 1526, see *supra* note 2.

³⁹ *K Mart Corp.*, 108 S. Ct. at 1818. This is the "case 2a" situation.

⁴⁰ *Id.* The Court noted that: "Because of this ambiguity '[t]he Patent and Trademark Office takes the position that ownership of marks among parent-subsidiary corporations . . . is largely a matter to be decided between the parties themselves.'" *Id.* at 1821 (Brennan, J., concurring) (quoting 1 J. MCCARTHY, TRADEMARKS AND UNFAIR COMPETITION 748 (2d ed. 1984)). This ambiguity does not exist in instances involving relationships similar to cases 2b and 2c. In cases 2b and 2c the U.S. trademark holder is the parent corporation and the true owner of the trademark, while the foreign firm is the subsidiary or division. *Id.* at 1826 (Brennan, J., concurring).

⁴¹ *Id.* According to the Court, "merchandise of foreign manufacture" can be interpreted as goods manufactured in a foreign country, goods manufactured by a foreign company, or goods manufactured in a foreign country by a foreign company. *Id.* The situations in which this phrase applies are referred to as case 2b and case 2c gray markets.

⁴² *Id.* at 1818. Justice Kennedy elaborated on the possible confusion facing the Customs Service because of the different interpretations that result from ambiguous words in statutes. He stated:

I believe that agency regulations may give a varying interpretation of the same phrase when that phrase appears in different statutes and different statutory contexts. There may well be variances in purpose or circumstance that have led the agency to adopt and apply dissimilar interpretations of the phrase "of foreign manufacture" in other regulations implementing different statutes.

Id. at 1818 n.4. Justice Kennedy pointed out that the Supreme Court permits an agency to choose any reasonable definition of ambiguous phrases. *Id.* at 1817. The Court in *United States v. Shimer* stated "[i]f this choice represents a reasonable accommodation of conflicting policies that were committed to the agency's care by the statute, we should not disturb it unless it appears from the statute or its legislative history that the accommodation is not one that Congress would have sanctioned." 367 U.S. 374, 383 (1961). For a discussion on an agency's role in statutory construction, see *supra* note 34. As a result, the Customs Service is allowed to interpret the statute to read that goods manufactured by a foreign subsidiary or division of a domestic company are not goods "of foreign manufacture." *K Mart Corp. v. Cartier, Inc.*, — U.S. —, 108 S. Ct. 1811, 1818 (1988).

⁴³ *K Mart Corp.*, 108 S. Ct. at 1817. Justice Kennedy, writing for the Court, stated that the decisive question in determining the correct interpretation of a statute is whether the "language of the statute is clear or arguably ambiguous." *Id.* at 1818 n.4. He maintained that "[t]he purported gloss any party gives to the statute, or any reference to legislative history, is in the first instance irrelevant." *Id.*

reasons behind the common-control exception.⁴⁴ According to Brennan, section 526 protects U.S. trademark owners from competing foreign merchandise bearing trademarks identical to U.S. trademarks.⁴⁵ Brennan stated that Congress would never extend the protections provided by section 526 to affiliates of foreign manufacturers because of protectionist sentiments.⁴⁶ Therefore, the majority's acceptance of the common-control exception was consistent with the prevailing protectionist attitudes.⁴⁷

Justice Brennan also recognized the equitable motivation for excluding foreign affiliates from the protection of section 526.⁴⁸ In a typical gray market situation, the U.S. markholder has no control over the independent foreign manufacturer's sales abroad to third parties who might ultimately import the goods into the United States.⁴⁹ Domestic firms with a registered U.S. trademark for goods manufactured abroad may have more authority over the actions of its subsidiary or division. The firm may also have some influence over the parent.⁵⁰ On the other hand, the U.S. trademark owner who purchased the trademark at arm's length from an independent for-

⁴⁴ *Id.* at 1819. Justice Marshall and Justice Stevens concurred with Justice Brennan and affirmed the common-control exception. In their decision they relied on the fundamental purpose of section 526 to protect only domestic interests. *Id.*

⁴⁵ 19 U.S.C. § 1526 (1987).

⁴⁶ *K Mart Corp.*, 108 S. Ct. at 1820. Justice Brennan maintained that if a foreign manufacturer could, merely by establishing a subsidiary in the United States, "insulate itself so easily from the competition of parallel imports, much of section 526's limiting language would be pointless." *Id.* at 1821.

The Tariff Act of 1930, which imposed the highest tariff duties in United States history, was representative of the protectionist viewpoint in the early 1930s. See Kersner & Stein, *supra* note 1, at 260 n.48. In 1929 the Senate attempted to amend section 526 to delete the final clause allowing U.S. trademark holders to consent to importation of foreign goods bearing their trademark. See S. REP. No. 37, 71st Cong., 1st Sess. 75 (1929). The Senate Committee on Finance maintained that "where the laws of the United States protect the interest of a trademark holder by allowing him a monopoly in the use of the mark, it is reasonable to require as far as practicable, that in return, the holder of the mark shall manufacture his goods in the United States." *Id.* Nevertheless, Congress reenacted section 526 without any change in the Tariff Act of 1930. See 19 U.S.C. § 1526 (1982).

The same protectionist sentiments that prevailed in the late 1920s and resulted in the Tariff Act of 1930 are still prevalent largely due to the growing trade deficit. See Mackintosh, *supra* note 7, at 210. Protectionists desire a policy against gray market imports that would isolate the U.S. market from some foreign competition and preserve the domestic industry. *Id.*

⁴⁷ *K Mart Corp.*, 108 S. Ct. at 1821. Justice Brennan further stated:

The barriers that Congress erected seem calculated to serve no purpose other than to reserve exclusively to domestic, not foreign, interests the extraordinary protection that section 526 provides. But they are fragile barriers indeed if a foreign manufacturer might by pass them by the simple device of incorporating a shell domestic subsidiary and transferring to it a single asset—the U.S. trademark.

Id. at 1820-21.

⁴⁸ *Id.* at 1822-23.

⁴⁹ See *id.* at 1823.

⁵⁰ *Id.* The U.S. company and its foreign branch have many options available. They may choose not to import directly to any other domestic firm or if possible prescribe resale restrictions as a condition to sales. See *id.*

eign firm stands to lose an appreciable amount because of gray market competition.⁵¹

A different majority of the Court found the authorized-use exception⁵² invalid.⁵³ The Court reasoned that this exception was inconsistent with the plain language of the statute.⁵⁴ In this situation a U.S. trademark owner who authorized an independent foreign manufacturer to use his trademark abroad would be unable to utilize section 526 to prohibit the importation of goods produced by this foreign firm.⁵⁵ The Court found that this situation contradicted the plain meaning of the statute.⁵⁶ The ambiguous phrases in section 526, "owned by" and "of foreign manufacture," do not apply to the authorized-use exception.⁵⁷

Justice Scalia, in a separate opinion, discussed the policy reasons for rejecting the authorized-use exception and extending protection to U.S. trademark owners who have authorized a foreign firm to use its U.S. trademark abroad.⁵⁸ According to Justice Scalia, the equitable motivations existing in this gray market are similar to those in the typical gray market situation.⁵⁹ Both gray market victims have the same investment at stake, and the assignor's risk may be even greater.⁶⁰ The assignor risks the decline of the entire goodwill associated with his trademark in this country.⁶¹ Consequently, U.S. companies who authorize the use of their trademarks abroad should be granted the same protection that is available to the U.S. trademark owner in the typical gray market situation.⁶²

⁵¹ *Id.* Not only do U.S. trademark owners invest a large sum of money to purchase the trademark rights, but they expend more in securing the domestic goodwill of the product. See Comment, *supra* note 1, at 60. Typical expenses include sales promotion and brand advertising, inventory maintenance, customer relations, dealer training, and warranty service. The domestic company in the case 2 situation does not have the same type of investment at stake. *K. Mart Corp.*, 108 S. Ct. at 1823. The U.S. firm, in a relationship such as case 1, deserves the protection of his property interest. *Id.* See also Comment, *supra* note 1, at 98. An affiliated member of a foreign company, however, should not have access to section 526 for the purpose of securing a monopoly for its product in the United States.

⁵² 19 C.F.R. § 133.21(c)(3).

⁵³ *K. Mart Corp.*, 108 S. Ct. at 1819. Chief Justice Rehnquist, Justice Blackmun, Justice O'Connor, and Justice Scalia concurred with Kennedy in this result. *Id.* at 1814.

⁵⁴ *Id.* The Court concluded that invalidating and severing the authorized-use exception from the regulation would not disturb the force of the statute. *Id.*

⁵⁵ 19 C.F.R. § 133.21(c)(3).

⁵⁶ *K. Mart Corp.*, 108 S. Ct. at 1819. According to the Court, 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. *Id.* at 1818-19.

⁵⁷ *Id.* at 1818.

⁵⁸ *K. Mart Corp.*, 108 S. Ct. at 1836 (Scalia, J., concurring in part, dissenting in part).

⁵⁹ *Id.*

⁶⁰ *Id.*

⁶¹ *Id.* According to Justice Scalia: "The U.S. assignee's innocent vulnerability to gray-market imports is no greater than that of the U.S. trademark owner who assigns the right to use his trademark abroad . . ." *Id.*

⁶² *Id.*

Justice Brennan disagreed with Scalia and stated that the equitable motivations for excluding the foreign affiliates from section 526's protection apply equally to the situation when a U.S. firm authorizes a third party to use its trademark abroad.⁶³ According to Brennan, the U.S. trademark owner has the ability to avoid this type of competition by refusing to license its trademark use overseas or by revoking an already issued license.⁶⁴ Brennan stated that the authorized-use exception should be upheld as reasonable.⁶⁵

Prior to the Court's decision in *K Mart Corp.*, courts disagreed over the scope of protection afforded by section 526 and the role of the Customs Service's regulation in the enforcement of the statute.⁶⁶ Congress enacted section 526 of the Tariff Act in response to a Second Circuit Court of Appeals decision, *A. Bourjois & Co. v. Katzel*,⁶⁷ in which the court refused to enjoin a parallel importation in the typical gray market situation.⁶⁸ The language of the regulation has also changed numerous times.⁶⁹

⁶³ *Id.* at 1830.

⁶⁴ *Id.*

⁶⁵ *Id.*

⁶⁶ *Coalition to Preserve the Integrity of Am. Trademarks v. United States*, 790 F.2d 903 (D.C. Cir. 1986) (rejecting the regulation as inconsistent with section 526); *Vivitar Corp. v. United States*, 761 F.2d 1552 (Fed. Cir. 1985) (concluding that the regulation was consistent with section 526); *Sturges v. Clark D. Pease*, 48 F.2d 1035 (2d Cir. 1931) (upholding section 526 in its broad form); *Osawa & Co. v. B & H Photo*, 589 F. Supp. 1163 (S.D.N.Y. 1984) (rejecting the related-party exception in the regulation as contrary to the plain meaning of section 526); *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 548 F. Supp. 1063 (E.D.N.Y. 1982) (rejecting the related-party exception in the regulation as contrary to section 526).

⁶⁷ 275 F. 539 (2d Cir. 1921), *rev'd*, 260 U.S. 689 (1923).

⁶⁸ *See Note, supra* note 7, at 91.

⁶⁹ For a discussion of the changes in section 526 since 1922, see *Vivitar Corp. v. United States*, 761 F.2d 1552, 1565-66 (Fed. Cir. 1985). In 1923 the agency first established a regulation that barred the entry of foreign goods with a U.S. registered trademark without the consent of the trademark owner. *Id.* at 1566. The original language of the regulation merely recognized the fact that the U.S. trademark owners were entitled to the protection of section 526. *Id.* The language, however, neither limited the scope of protection afforded by section 526, or provided any indication of the agency's interpretation of the statute. *See Note, supra* note 7, at 99. *See also Comment, supra* note 1, at 71. No exceptions to this protection were provided. *Vivitar Corp.*, 761 F.2d at 1565-66.

In 1936 the Customs Service first acted to restrict section 526's broad protection. *Id.* at 1566. The Customs Service took a new approach and combined regulations controlling section 526 and The Trademark Act into one regulation. This regulation prohibited goods that copied or simulated the registered trademark. *See Comment, supra* note 1, at 72. Under the 1936 amendments, when the foreign trademark owner and the U.S. trademark owner were the same person, partnership, association, or corporation, the importation of such goods was not prohibited. *Vivitar Corp.*, 761 F.2d at 1566.

In 1953 the agency added the "related company" exception that denied protection to affiliated companies from parallel imports. *Vivitar Corp.*, 761 F.2d at 1566. According to section 45 of the Lanham Act, "related company" is defined as "any person who legitimately controls or is controlled by the registrant or applicant for registration in respect to the nature and quality of the goods or services in connection with which the mark is used." 15 U.S.C. § 1127 (1982). In addition, the 1953 regulations required U.S. companies to disclose to the agency all related companies. Later in 1959 Customs returned to the more limited 1936 statute that included the "same entity" exception. *Vivitar Corp.*, 761 F.2d at

In the early 1900s courts and commentators believed that trademarks provided the holder with neither a property interest nor monopoly power over intrabrand competition.⁷⁰ Rather, their utility was to inform consumers of the origin of the product.⁷¹ Use of the trademark by competitors was acceptable so long as the merchandise was identical to the goods of the domestic company.⁷² The Second Circuit Court of Appeals upheld this "universality theory" in *Katzel*.⁷³

In *Katzel* a French manufacturer of face powder sold its U.S. trademark and U.S. business to a U.S. citizen, A Bourjois & Co. The U.S. company continued to purchase the face powder in bulk from the French manufacturer, and the French manufacturer continued to sell the powder with the same trademark in France. The defendant purchased the face powder in France and imported it into the United States for resale. The U.S. trademark owner, Bourjois, filed suit under the Trademark Act. The Second Circuit, relying on the belief that genuine goods cannot infringe a U.S. trademark, reversed the district court and allowed the importation.⁷⁴ This result, however, seemed unfair to the domestic markholder who purchased a foreign manufacturer's trademark rights for exclusive sales in the United States and who would be forced to compete with the cheaper gray market goods under this theory. Congress reacted by enacting the predecessor of section 526. The U.S. Supreme Court later reversed the Second Circuit and held that the true significance of a trademark was not indication of origin, but evidence of the local business goodwill of the U.S. markholder.⁷⁵

1567. With the return to a less restrictive regulation, a domestic affiliate of a foreign firm who qualifies as the "same company" could restructure the corporate organization to a "related company" that was not excluded. See Comment, *supra* note 1, at 75. Because of this opportunity for abuse, Customs began interpreting "same entity" to include a parent/subsidiary relationship and permitted entry of these goods. *Vivitar Corp.*, 761 F.2d at 1567. In addition, the revised regulations did not require disclosure except in a principle/agent relationship. *Id.*

In 1972 the agency promulgated the "common-control" and "authorized-use" exceptions presently employed. 19 C.F.R. § 133.21(c)(1)-(3) (1987). For the text of section 133.21(c), see *supra* note 9. From 1923 to 1936 and from 1959 to 1972 the Customs Service permitted entry of genuine goods even if the foreign firm and the U.S. company were related. See Note, *supra* note 7, at 101.

⁷⁰ *Katzel*, 275 F. at 543. See also Atwood, *supra* note 7, at 303; Note, *The Gray Market Controversy: Is a Resolution Necessary?*, 13 BROOKLYN J. INT'L L. 279, 285 n.33 (1987).

⁷¹ *Katzel*, 275 F. at 543.

⁷² *Id.* Under the universality theory of trademark law, the function of the trademark is to indicate the source of origin or producer. See Atwood, *supra* note 7, at 303. Once a trademark is legally applied to merchandise, these goods can be sold anywhere and will not be an infringement even if the goods enter another country where another person owns the exclusive right to that trademark. Comment, *supra* note 7, at 107. Under the universality principle, the U.S. trademark assignee's only rights against its foreign assignor are for breach of contract or unfair competition. *Id.*

⁷³ 275 F. at 540.

⁷⁴ *Id.* at 543.

⁷⁵ *A. Bourjois & Co. v. Katzel*, 260 U.S. 689 (1923). This case was a trademark in-

Because the Court reversed *Katzel*, the validity of the universality principle of trademark law is questionable. Courts have employed the "territoriality theory" instead.⁷⁶ This theory provides that because a trademark was a formation of each country's laws, no nation's trademark laws could be applied outside the country to create "universal" trademarks.⁷⁷ The territoriality viewpoint is the current state of trademark law.⁷⁸

In 1931 the Second Circuit Court of Appeals in *Sturges v. Clark D. Pease*⁷⁹ upheld section 526 in its broad form and refused to allow the importation of a good for personal use if it contained a U.S. trademark purchased and owned by a U.S. company.⁸⁰ The *Sturges* court concluded that the U.S. trademark owner is entitled to the benefit of all the sales in the United States of goods bearing that trademark.⁸¹ As a result, the *Sturges* court rejected the argument that section 526's protection should be applied only to the typical gray market situation.⁸²

Because of the expansion of the gray market in the 1980s, litigation over the scope of section 526 increased dramatically.⁸³ Trademark holders challenged the validity of the Customs Service regulations.⁸⁴ Many U.S. trademark holders doubted the agency's authority to construe the statute so narrowly because the agency first enforced the restrictions long after the original enactment of section 526⁸⁵ and because of the broad wording of the statute.⁸⁶ The courts' decisions varied greatly with the rulings based on legislative history of section 526, administrative interpretation, and previous judicial decisions.⁸⁷

fringement case and not a suit against importation. Consequently, the Court did not mention the predecessor of section 526.

⁷⁶ *Osawa & Co. v. B & H Photo*, 589 F. Supp. 1163, 1171 (S.D.N.Y. 1984) (stating that the territoriality theory has replaced the universality theory).

⁷⁷ *Katzel*, 260 U.S. at 692. See also *Coalition to Preserve the Integrity of Am. Trademarks v. United States*, 598 F. Supp. 844, 848 (D.D.C. 1984).

⁷⁸ See Note, *supra* note 7, at 107.

⁷⁹ 48 F.2d 1035 (2d Cir. 1931). In this case the plaintiff purchased an Hispano-Suiza car in France and was prevented from importing it into the U.S. because it contained the same trademark that was registered in the United States by the defendant. *Id.*

⁸⁰ *Id.* at 1037.

⁸¹ *Id.* The court reasoned that if section 526 did not apply to personal use, goods that were really intended for resale might enter under the guise of personal use. *Id.*

⁸² *Id.* Because the *Sturges* court rejected a relatively minor exception for personal use, the court would probably not have permitted the larger exceptions included in the present Customs Service regulation. See *Kersner & Stein, supra* note 1, at 267.

⁸³ *Kersner & Stein, supra* note 1, at 271.

⁸⁴ See *supra* note 13. Trademark owners first directed their efforts to the legislature. After fruitless lobbying efforts, the trademark owners turned to the courts for relief. *K Mart Corp. v. Cartier, Inc.*, — U.S. —, 108 S. Ct. 1811, 1819 (1988).

⁸⁵ *Coalition to Preserve the Integrity of Am. Trademarks v. United States*, 790 F.2d 903, 917 (D.C. Cir. 1986).

⁸⁶ *K Mart Corp.*, 108 S. Ct. at 1819-20.

⁸⁷ See *supra* note 11.

The first group of litigation during the 1980s consisted of suits brought against identified importers of gray market goods. For example, in *Bell & Howell: Mamiya Co. v. Masel Supply Co.*⁸⁸ a U.S. corporation, owned by two subsidiaries of a Japanese corporation, and the holder of the U.S. trademark brought suit to enjoin an importer from distributing products bearing its trademarks.⁸⁹ The court rejected the common-control exception and stated that section 526 conferred the right to bar importations to all U.S. citizens.⁹⁰ The district court also rejected the common-control exception in *Osawa & Co. v. B & H Photo* as contrary to the plain meaning of section 526.⁹¹ The court reasoned that section 526 contained no indication that its scope depended on subtle variations in the relationship between the U.S. markholder and the foreign markholder.⁹²

Prior to the Court's decision in *K Mart Corp.*, three lower courts addressed the validity of the regulations.⁹³ All three cases involved goods bearing a trademark owned by a U.S. company that were imported into the United States.⁹⁴ The imported goods had been manufactured by foreign affiliates of the U.S. trademark owner.⁹⁵ The Customs Service concluded that the goods were exempt from section 526 under the common-control exception. The trademark owners brought suit against the Secretary of the Treasury, the United States, and the Customs Service and sought both a declaration that the regulations were invalid and injunctive relief to prohibit their enforcement.⁹⁶

In *Vivitar Corp. v. United States*⁹⁷ the Federal Circuit concluded that the trademark holders were relying erroneously on the assumption that the Customs' regulations were legislative rules having the

⁸⁸ 548 F. Supp. 1063 (E.D.N.Y. 1982). The plaintiff sold photographic equipment that was manufactured in Japan. *Id.*

⁸⁹ *Id.* at 1063.

⁹⁰ *Id.* at 1078-79. According to the court: "The language does not reasonable admit of a special limitation based upon foreign ownership of an American company. An American subsidiary of a foreign company is no less American for being a foreign company's subsidiary . . ." *Id.* at 1075-76. On appeal, the Second Circuit vacated the district court's preliminary injunction on the ground that the plaintiff failed to show irreparable harm. *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 719 F.2d 42, 46 (2d Cir. 1983).

⁹¹ *Osawa & Co. v. B & H Photo*, 589 F. Supp. 1163, 1177 (S.D.N.Y. 1984).

⁹² *Id.* at 1177. The *Osawa* court also would not limit the application of section 526 to the narrow fact situation in *Katzel*. According to the court, the "defendants have suggested no compelling reason to doubt that the statute means what it says." *Id.* at 1175.

⁹³ See *Coalition to Preserve the Integrity of Am. Trademarks v. United States*, 790 F.2d 903 (D.C. Cir. 1986); *Olympus Corp. v. United States*, 792 F.2d 315 (2d Cir. 1986); *Vivitar Corp. v. United States*, 761 F.2d 1552 (Fed. Cir. 1985).

⁹⁴ *Id.*

⁹⁵ *Id.*

⁹⁶ *Id.*

⁹⁷ *Vivitar Corp.*, 761 F.2d at 1552. In *Vivitar Corp.* the trademark holder was a California corporation and the owner of the VIVITAR trademark. *Id.* at 1556. Vivitar Corporation distributes in the United States and overseas photographic equipment that is produced in Japan. *Id.*

force of law.⁹⁸ According to the court, Congress had not delegated such authority to the Customs Service under section 526.⁹⁹ Rather, the regulations merely defined Customs' role in the administrative enforcement of the statute and had no effect on the scope of protection provided by section 526.¹⁰⁰ In addition, the court reasoned that U.S. trademark owners who felt that Customs had mistakenly permitted imports bearing their trademark could take their complaint to the courts.¹⁰¹ In this light, the court concluded that the regulation was consistent with the statute.¹⁰²

In *Olympus Corp. v. United States* the Second Circuit concurred with *Vivitar Corp.* and concluded that the regulations limit only the court's obligation to enforce the statute by excluding goods; the regulations do not limit the scope of the protection.¹⁰³ The court did find the regulation to be of "questionable wisdom," but upheld it because of congressional acquiescence to the long-standing administrative practice.¹⁰⁴ Accordingly, the court maintained that any changes should result from the legislature.¹⁰⁵ The *Olympus Corp.* court upheld the regulation and concurred with *Vivitar Corp.* on the availability of a private action to aggrieved markholders.¹⁰⁶

⁹⁸ *Id.* at 1569.

⁹⁹ *Id.*

¹⁰⁰ *Id.*

¹⁰¹ *Id.* at 1570.

¹⁰² *Id.* at 1570-71. While the *Vivitar Corp.* court upheld the regulations, the court did not conclude that the regulations controlled the scope of section 526. *Id.*

¹⁰³ *Olympus Corp. v. United States*, 792 F.2d 315, 320 (2d Cir. 1986). In this case, the plaintiff was a wholly owned subsidiary of the Olympus Optical Co., Ltd., a Japanese Corporation that produces photographic equipment. *Id.* at 317. The plaintiff is the registered owner of the OLYMPUS trademark in the United States. *Id.*

¹⁰⁴ *Id.* at 320. In his dissent, Judge Winter objected to the majority's deference to Congress' purported long-standing acquiescence. Rather, Winter focused on the lack of continuity in the practice of the Customs Service. *Id.* at 322 (Winter, J., dissenting).

¹⁰⁵ *Id.* at 320-21. The *COPIAT* court took the opposite position. In *COPIAT* the court believed that merely because Congress has failed to enact legislation to the contrary does not mean that they accept the practice of Customs. According to the court: "Congress cannot be obliged affirmatively to correct subsequent administrative interpretations inconsistent with original legislative intent; that is the responsibility of the courts." *Coalition to Preserve the Integrity of Am. Trademarks v. United States*, 790 F.2d 903, 917 (D.C. Cir. 1986). See also *Vivitar Corp. v. United States*, 761 F.2d 1552, 1568 (Fed. Cir. 1985).

¹⁰⁶ *Olympus Corp.*, 792 F.2d at 320. Customs may limit its role in the gray market controversy because there also exists a private right of action under the Genuine Goods Exclusion Act, section 526 of the Tariff Act of 1930. Section 526(c) reads:

Any person dealing in any such merchandise may be enjoined from dealing therein within the United States or may be required to export or destroy such merchandise or to remove or obliterate such trademark and shall be liable for the same damages and profits provided for wrongful use of a trademark under the provisions of section 81 to 109 of title 15.

19 U.S.C. § 1526(c) (1987). A U.S. trademark owner who has registered its trademark with the Patent and Trademark office and Customs may sue anyone importing trademarked merchandise without prior written consent. *Olympus Corp.*, 792 F.2d at 320. The majority view was that this private remedy is not limited by the common-control exception in Customs' regulations. Once the trademark has been recorded with the proper authorities, the U.S. trademark owner may sue in federal court to prevent the unauthorized im-

In *The Coalition to Preserve the Integrity of American Trademarks v. United States*¹⁰⁷ the District of Columbia Circuit, however, rejected the regulation as inconsistent with section 526.¹⁰⁸ According to the court, the statute, by its plain meaning, does not allow exceptions based upon either a relationship that might exist between the domestic and the foreign trademark holder or on the authorization of the U.S. holder for use of the mark abroad.¹⁰⁹ In considering giving deference to the agency's practice,¹¹⁰ the court concluded that "the Customs Service's interpretation of Section 526 does not display the necessary thoroughness, validity, and consistency to merit judicial acceptance."¹¹¹ In addition, the *COPIAT* court, although agreeing with the *Vivitar Corp.* court's finding of inconsistency,¹¹² rejected the *Vivitar Corp.* court's holding that the regulation can be upheld as a reasonable exercise of administratively initiated enforcement.¹¹³ The court reasoned that because the Customs Service has never offered this justification before, it cannot rely upon it now.¹¹⁴ The court granted the appellants declaratory relief, but denied their request for an injunction.¹¹⁵

In *K Mart Corp.* the Supreme Court resolved the split in the Circuits and narrowed the circumstances in which gray market goods may enter the United States under regulatory approval by invalidating the authorized-use exception and defining the scope of the common-control exception.¹¹⁶ While the Court stated that its decision was based on the rules of statutory construction, the Court's decision clearly reflects its recognition of policy considerations. For example, the Court noted the increased volume of gray market imports and the need for a cohesive policy.¹¹⁷ The Court also pointed out that when a U.S. trademark holder sells goods domestically at a higher

portation of genuinely trademarked items. This private action may at times prove to be an inadequate remedy. Identifying the gray market importers may be difficult and it may lead to an endless series of lawsuits. Restani, *An Introduction to the Gray Market Controversy*, 13 BROOKLYN J. INT'L L. 235, 242 (1987).

¹⁰⁷ 790 F.2d at 903. See *supra* note 18.

¹⁰⁸ 790 F.2d at 913.

¹⁰⁹ *Id.* This court believed that "what the statute meant in 1922 and in 1930 is what it means today." *Id.*

¹¹⁰ *Id.* The court determined that deference to an agency's construction is inappropriate when the intent of Congress is evident. *Id.* at 914.

¹¹¹ *Id.* at 916.

¹¹² *Id.* at 917. Both the *Vivitar Corp.* and *COPIAT* courts believed that the Customs Service regulations do not represent a reasonable interpretation of section 526. See *Vivitar Corp. v. United States*, 761 F.2d 1552, 1565-68 (Fed. Cir. 1985).

¹¹³ See *Vivitar Corp.*, 761 F.2d at 1571.

¹¹⁴ *Coalition to Preserve the Integrity of Am. Trademarks v. United States*, 790 F.2d 903, 918 (D.C. Cir. 1986).

¹¹⁵ *Id.* The court believed that injunctive relief would be inappropriate at this time, but remanded to the district court for the issuance of a declaratory judgment stating that the common-control and authorized-use exceptions are invalid. *Id.* at 918.

¹¹⁶ *K Mart Corp. v. Cartier, Inc.*, — U.S. —, 108 S. Ct. 1811, 1812-13 (1988).

¹¹⁷ *Id.* at 1828.

price than for which they are sold abroad, the incentive arises for importers to purchase these goods abroad and resell them in the United States at a lower price than the U.S. firm.¹¹⁸ Gray market goods also obtain a free ride on the promotion, advertising, and goodwill of the U.S. company. In addition, most gray market goods lack the services and warranties that accompany U.S. goods.¹¹⁹

In *K Mart Corp.* the Court looked to the rules of statutory construction.¹²⁰ The Court noted that when a statute is clear and unambiguous, courts do not defer to an agency's interpretation.¹²¹ On the other hand, an agency is allowed to interpret ambiguous language in any reasonable manner so long as the agency's interpretation does not contradict the plain meaning of the statute.¹²² Because the exact meaning of "owned by" and "merchandise of foreign manufacture" were unclear, the Court concluded that the Customs Service's interpretations were reasonable and allowed them to stand.¹²³ The Court applied the statutory interpretation rules to the authorized-use exception and concluded that the exception is contrary to the plain meaning of the statute.¹²⁴ The Court left unanswered the appropriate role, in evaluating administrative regulations, of legislative history, agency procedure, and congressional acquiescence. Justice Kennedy determined that these considerations were unimportant to the Court's analysis. According to Kennedy, the only pertinent questions were whether the statute was ambiguous and whether the agency's regulations were reasonable interpretations. Nevertheless, he noted that in other contexts the legislative history and agency practice may be the only issues for consideration.¹²⁵ As a result, courts addressing different factual situations may not benefit from *K Mart Corp.* in their assessments.

Because the majority reached its decision by applying the rules for statutory construction, the validity of the universal and territorial theories relied upon by lower courts remains uncertain. For example, one dispute concerned whether Congress intended for this amendment to the Tariff Act of 1922 to completely reject the universality theory or to merely correct an inequity in the existing trademark law. Most of the lower courts believed that Congress actually

¹¹⁸ *Id.* This enables the importers to capture a share of the profits. See *Olympus Corp. v. United States*, 792 F.2d 315, 320 (2d Cir. 1986).

¹¹⁹ See Note, *supra* note 7, at 85.

¹²⁰ *K Mart Corp.*, 108 S. Ct. at 1817.

¹²¹ *Id.* at 1817. The Court noted that "traditional deference given to an agency's interpretation is not to be applied to alter the clear expressed intent of Congress." *Id.* (quoting *Board of Governors v. Dimension Financial Corp.*, 474 U.S. 361, 368 (1986)). For a discussion on statutory construction, see *supra* note 34.

¹²² *K Mart Corp.*, 108 S. Ct. at 1817.

¹²³ *Id.* at 1818.

¹²⁴ *Id.* at 1818-19.

¹²⁵ *Id.* at 1818 n.4.

intended a sweeping rejection of the prevailing view that a trademark that is genuine in a foreign country would be genuine in the United States.¹²⁶ According to this view, Congress intended a broad scope for section 526.¹²⁷ In *K Mart Corp.* Kennedy did not discuss the scope of trademark law.¹²⁸ In his opinion, Kennedy upheld the regulation by relying on statutory interpretation, and did not address congressional intent.¹²⁹ Justice Brennan,¹³⁰ however, in a separate opinion, concluded that Congress' only purpose in enacting section 526 was to overrule *Katzel*¹³¹ by protecting the typical gray market situation and not to completely overhaul the theory of trademark law.¹³² The intent of Congress in enacting section 526 remains uncertain even after the *K Mart Corp.* decision. Unless Congress acts to clarify its position with further legislation, courts will determine the scope of section 526 by using rules of statutory construction.

Another unresolved issue involves the role of the Customs Service's actual practice regarding gray market imports. Circuit courts believed that this role was significant in their determinations. The Second Circuit in *Olympus Corp.* believed that Customs had consistently interpreted the statute to allow them to permit entry of trademarked goods imported under the common-control exception.¹³³ The Federal Circuit in *Vivitar Corp.*, however, argued that Customs has continuously changed its view of its role of interpreting section 526.¹³⁴ The *Vivitar Corp.* court stated that the Customs Service adjusts its regulations to reflect current judicial decisions and should not be relied on to make judgments.¹³⁵ In *K Mart Corp.* Justice Kennedy did not rely on the role of the Customs Service. Nevertheless, Justice Brennan, in a separate opinion, reasoned that Customs maintained a long-standing position of not protecting trademarked goods

¹²⁶ *Coalition to Preserve the Integrity of Am. Trademarks v. United States*, 790 F.2d 903, 910 (D.C. Cir. 1986).

¹²⁷ *See id.* at 912; *Vivitar Corp. v. United States*, 761 F.2d 1552, 1562 (Fed. Cir. 1985); *Sturges v. Clark D. Pease*, 48 F.2d 1035, 1037 (2d Cir. 1931); *Osawa & Co. v. B & H Photo*, 589 F. Supp. 1163, 1175 (S.D.N.Y. 1984); *Bell & Howell: Mamiya Co. v. Masel Supply Co.*, 548 F. Supp. 1063, 1077 (E.D.N.Y. 1982).

¹²⁸ *K Mart Corp.*, 108 S. Ct. at 1817-19.

¹²⁹ *Id.*

¹³⁰ Justice Marshall and Justice White joined Justice Brennan. *Id.* at 1819.

¹³¹ *Id.* at 1823. Justice Brennan wrote: "The sparse legislative history confirms that Congress's sole goal was to overrule *Katzel*." *Id.* at 1824.

¹³² *Id.* at 1826. Justice Brennan stated that "since Congress did not so much as hint that it was engaged in such an ambitious task, the more plausible reading of the cryptic Conference Report is that Congress intended merely to remedy a specific inequity that the prevailing doctrine produced, not to abolish the entire doctrine that produced it." *Id.*

¹³³ *Olympus Corp. v. United States*, 792 F.2d 315, 319 (2d Cir. 1986).

¹³⁴ The Customs Service, joined by the Department of Justice, filed *amicus curiae* brief for *Masel Supply Co.* in which they stated that section 526 should be construed in accordance with the plain language of the statute. *Vivitar Corp. v. United States*, 761 F.2d 1552, 1568 (Fed. Cir. 1985). This represents a drastic change of opinion. *See Kersner & Stein, supra* note 1, at 271.

¹³⁵ *Vivitar Corp.*, 761 F.2d at 1568.

from affiliated firms.¹³⁶

The *K Mart Corp.* decision provides concrete guidance to U.S. trademark owners, parallel importers, and the Customs Service. The Court legitimized the administrative practice of permitting entry of gray market goods if the foreign manufacturer and the U.S. company are related. Nevertheless, this regulatory authority does not necessarily prevent further disputes. In its analysis, the Court enumerated the possible international corporate relationships and studied their effects on the gray market and competition. By upholding the common-control exception, the Court reasoned that Congress did not set out to provide the means, through section 526, for foreign or multinational corporations to enforce exclusive U.S. distributorships.

As a result of the Court's decision to exclude related entities from the protection of section 526, the Customs Service may face intricate corporate restructuring developed to circumvent the meaning of common-control. Because the regulations define "common ownership" as "individual or aggregate ownership of more than 50 percent of the business entity,"¹³⁷ and define "common control" as the "effective control in policy and operations,"¹³⁸ multinational corporations could manipulate their holdings to become a U.S. company that is not related or controlled by the foreign entity.¹³⁹ While this is a possibility, it is unlikely that it would be successful given Customs' experience in dealing with gray marketeers.

Because demand for discounted goods in the United States is so high the gray market controversy is likely to continue.¹⁴⁰ In addition, there is a strong incentive on the part of trademark owners to protect their trademark from all gray market exploitation.¹⁴¹ Trademark owners will turn to new legal theories to achieve their desired results.¹⁴²

¹³⁶ *K Mart Corp. v. Cartier, Inc.*, — U.S. —, 108 S. Ct. 1811, 1819 (1988) (Brennan, J., concurring). Because Justice Brennan did not write for the majority, his opinion does not have the value of precedent.

¹³⁷ 19 C.F.R. § 133.2(d)(1) (1988).

¹³⁸ 19 C.F.R. § 133.2(d)(2) (1988).

¹³⁹ Sandler, *Gray Market Goods: The Controversy will Continue*, 13 BROOKLYN J. INT'L L. 267, 273 (1987). This would be accomplished with sound business planning that may result in a company with only 49% of it owned by the foreign entity. The actual foreign participation in the policy-making and operations control may be disguised so as not to be commonly controlled. *Id.*

¹⁴⁰ *Id.* at 276. With the gray market estimated at \$5 to \$10 billion annually, and with retailers such as K Mart Corporation, which purchased between \$250 and \$350 million of gray goods per year, gray market importation will remain a part of U.S. economy. Hansen, *supra* note 5, at 250 n.7, 257 n.29 (1987).

¹⁴¹ Sandler, *supra* note 139, at 277. These trademark owners have the resources and incentive to find ways to stop the flow of gray market goods. *Id.* Trademark owners are willing to engage in expensive litigation to protect their property interest and to increase the costs of doing business in the gray market. Hansen, *supra* note 5, at 250 n.7.

¹⁴² Private actions under section 526 are unlikely to be successful if the Customs Ser-

While the exact economic outcome of the Supreme Court's decision is uncertain,¹⁴³ the Court's rejection of the authorized-use exception may decrease gray market importation.¹⁴⁴ The fluctuations in the value of the U.S. dollar, however, account for the greatest variation in the volume of the gray market.¹⁴⁵ Regardless of the impact of the Court's decision on gray market importation, the Court ended the confusion and inconsistency surrounding the enforcement of section 526 in cases involving affiliated companies. No longer will there be a different holding for each circuit. By utilizing the rules for statutory construction, the Court made the correct decision regarding a controversial issue. Furthermore, the Court ruled in a manner that would withstand rehearing by the Court. *K Mart Corp.* is a fair decision that upholds the protection of section 526 in cases when a U.S. firm is the assignor or assignee of a trademark¹⁴⁶ (case 1 and case 3). For U.S. firms that are closely connected with foreign manufacturers, other avenues of protection are available such as internal distribution controls.¹⁴⁷ By legitimizing portions of the gray market, the Court encouraged the policy of competition in U.S. markets by enabling consumers to benefit from this competition.¹⁴⁸ Because the Court validated the common-control exception, the *K Mart Corp.* decision also has the practical effect of preventing a foreign manufacturer, through its U.S. distributor, from establishing artificially high

vice determines that an imported gray good comes under the common-control exception. As a result, trademark owners may protect their interests under copyright law. Instead of securing trademarks for their products, the owners may secure copyrights. Sandler, *supra* note 139, at 274. See also 17 U.S.C. § 602(a)-(b) (1982) (prohibiting copyright infringement). Trademark owners may also pursue alternative theories such as breach of contract claims and civil fraud claims to protect their property interest. Sandler, *supra* note 139, at 274. See *Johnson & Johnson v. Dal Int'l Trading*, 798 F.2d 100 (3d Cir. 1986). In *Johnson & Johnson* the seller claimed that it had been fraudulently induced to sell. *Id.* at 101.

¹⁴³ Some commentators and economic analysts believe that the potential consumer savings with gray goods is minimal. The gray good seller may attempt to sell the gray goods at a price close to the authorized U.S. dealer's retail price in order to increase his profit margin. In this instance, it is the gray marketeer who will benefit from the lower priced gray goods and not consumers. See *In re Certain Alkaline Batteries*, 225 U.S.P.Q. (BNA) 823, 835 (U.S.I.T.C. 1986) (finding that the price of gray market Duracell batteries is the same as U.S. trademarked Duracell batteries). See also Note, *supra* note 7, at 85-87 nn. 8, 9, & 11.

Other commentators believe that consumers are the ultimate beneficiaries of the gray market. By selling the gray goods for 30% to 40% below market price, these importers usually retail goods for less than the wholesale price set by U.S. exclusive dealers and still make a profit. *Are Those Cheap Commerce Prices for Real*, 50 CONSUMER REPS. 300 (1985).

¹⁴⁴ Hansen, *supra* note 5, at 255 n.26.

¹⁴⁵ Because gray marketeers usually operate on a small profit margin, a slight decline in the dollar affects the profitability of the enterprise and reduces the incentive to import gray goods.

¹⁴⁶ *K Mart Corp. v. Cartier, Inc.*, — U.S. —, 108 S. Ct. 1811, 1818-20 (1988). This involves a case 1 and case 3 gray market.

¹⁴⁷ *Id.* at 1823.

¹⁴⁸ 19 C.F.R. § 133 (1987).

prices in the United States and obtaining protection from arbitrage through the U.S. trademark laws.¹⁴⁹

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¹⁴⁹ Note, *supra* note 7, at 87 n.11.

