UNC SCHOOL OF LAW

NORTH CAROLINA JOURNAL OF INTERNATIONAL LAW AND COMMERCIAL REGULATION

Volume 23 | Number 2

Article 6

Winter 1998

# Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA, Co.: Gray Market Goods; Reason Makes a Run for the Border

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**Cover Page Footnote**
International Law; Commercial Law; Law

# NOTES

## *Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA, Co.*: Gray Market Goods; Reason Makes a Run for the Border

### I. Introduction

Businesses spend many years and millions of dollars building the value and strength of their trademarks. As a result, it is no surprise that these businesses also seek to reap from their trademarks as great a benefit as the law will allow. In the area of gray market goods,[1] the question of most significance to businesses is what benefit the law will allow: to what extent can trademark owners exclude gray market goods from the U.S. market?

The importation of gray market goods has a substantial impact on the U.S. economy.[2] Some commentators accordingly believe that trademark law should bar gray market goods completely.[3]

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[1] One commentator has defined gray market goods as:

> Goods manufactured by a trademark owner, or his authorized agent, but ultimately sold in the United States without that trademark owner's authority. These goods can be differentiated from counterfeit goods (goods to which trademarks have been affixed without the authority of the trademark owner) by the fact that the gray market goods were manufactured and the trademark affixed with the authority of the trademark owner.

Seth Lipner, *Trademarked Goods and Their Gray Market Equivalents: Should Product Differences Result in the Barring of Unauthorized Goods from the U.S. Markets?*, 18 HOFSTRA L. REV. 1029, 1029 (1990) (footnotes omitted).

[2] It is difficult to measure the extent of this impact. However, critics of the gray market estimate the damage to U.S. commercial industry in the billions of dollars. *See* Shashank Upadhye, *Rewriting the Lanham Trademark Act to Prohibit the Importation of All Gray Market Goods*, 20 SETON HALL LEGIS. J. 59, 60 (1996) ("In 1994, the International Trade commission stated that the gray market cost the industry between sixty to eighty billion dollars, a substantial increase from a 1987 cost of ten billion dollars." (citations omitted)).

[3] *See, e.g.*, Upadhye, *supra* note 2, at 66 ("[F]urther interpretations of the Lanham

Others argue that such an exclusionary policy cannot be supported by the principles of trademark law and would lead to substantial anticompetitive effects.[4] Most courts adopt the latter view, and require that some level of difference exist between the authorized and unauthorized goods before they allow trademark law to prohibit the importation of genuine goods.[5] And while the courts enunciate a standard of material difference, the application of this standard to certain goods is far from a simple matter.

The Fifth Circuit recently demonstrated the difficulty of applying the material difference standard in *Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA, Co.*[6] The court held that a material difference could be found based merely on patent stylistic differences between luxury goods and gray market equivalents.[7] In so doing, the Fifth Circuit extended to U.S.

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Act will only exacerbate the gray market problem and, consequently, the only practicable solution is to remove all ambiguities and to bar them completely."); Hugh C. Hansen, *Gray Market Goods: A Lighter Shade of Black*, 13 BROOK. J. INT'L L. 249, 262-65 (1987) (symposium) (arguing that fundamental trademark policies are undermined by gray market imports).

[4] *See* Gilbert Lee Sandler, *Gray Market Goods: The Controversy Will Continue*, 13 BROOK. J. INT'L L. 267, 272 (1987) (edited version of speech delivered at a symposium) ("If we have very real and specific problems, we should propose very real and specific solutions for those problems. We shouldn't be eliminating the broad sweep of trade which has been beneficial to the U.S. consumer and the U.S. public."); Lipner, *supra* note 1, at 1054 ("If trademark law is used to enjoin gray market sales without proof that the gray market goods are substantially different from the authorized goods, trademark law will have the effect of suppressing competition rather than protecting trademark rights and goodwill.").

[5] *See, e.g.*, Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F.2d 633 (1st Cir. 1992) (stating "[t]erritorial protections of the Lanham Act engage where two merchants sell physically different products in the same market and under the same name"); Lever Bros. Co. v. United States, 877 F.2d 101, 107 (D.C. Cir. 1989) (distinguishing cases where gray market goods are "physically identical" to the authorized goods); Original Appalachian Artworks, Inc. v. Granada Elecs., Inc., 816 F.2d 68, 73 (2d Cir.) (affirming permanent injunction against gray market importer of dolls because such dolls "were not intended to be sold in the United States and, most importantly were materially different from the [dolls intended for domestic market] sold in the United States . . . . It is this difference that creates the confusion over the source of the product and results in a loss of [the trademark owner's] goodwill."), *cert. denied*, 484 U.S. 847 (1987); Osawa & Co. v. B & H Photo, 589 F. Supp. 1163, 1165-70 (1984) (holding that because gray market camera importer did not provide point-of-sale servicing, irreparable injury resulted to plaintiff that did provide such servicing).

[6] 112 F.3d 1296 (5th Cir. 1997).

[7] *See infra* note 41 and accompanying text.

trademark owners the greatest possible protection against gray market goods. The cost of this protection, however, may be the erosion of the fundamental principle of trademark law that trademarks need be protected only insofar as to avoid consumer confusion.[8]

Part II of this Note will summarize the Fifth Circuit's opinion in *Martin's Herend Imports*.[9] Part III will discuss the background law in the area of gray market goods[10] and Part IV will examine the significance of the case in this context.[11] Part V will conclude that the Fifth Circuit decision can only be understood to favor the trademark owner's interest in protecting its goodwill to the detriment of the American consumer.[12]

## II. Statement of the Case

### *A. Facts and District Court Ruling*

Herendi Pocelangyar ("Herendi") is a Hungarian corporation which manufactures fine porcelain items such as tableware and figurines.[13] Herendi uses a trademark on these items consisting of a hand-painted design accompanying the HEREND name (the "mark").[14] The federal registration of this mark is held by Herendi.[15]

In order to export its goods to the United States, Herendi entered into an exclusive distributorship agreement with Martin's Herend Imports, Inc. (MHI), an American corporation.[16] This agreement authorized MHI to be the sole importer of Herend products in the United States.[17] Although Herendi manufactures

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8 *See infra* note 77 and accompanying text.

9 *See infra* notes 13-72 and accompanying text.

10 *See infra* notes 73-122 and accompanying text.

11 *See infra* notes 123-41 and accompanying text.

12 *See infra* Part V.

13 *See* Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA, Co., 112 F.3d 1296, 1299 (5th Cir. 1997).

14 *See id.*

15 *See id.*

16 *See id.*

17 *See id.*

"thousands of items[,]" MHI and Herendi jointly select only a limited number of items to import.[18]

Judith and Frank Juhasz owned Diamond & Gem Trading USA, Co. (collectively "Juhasz").[19] Juhasz acquired genuine Herendi goods bearing the mark from various sources, including Herendi company stores in Hungary, private collections, and other American sources.[20] Juhasz then sold these goods in the United States.[21] Although some of the goods sold by Juhasz were among the select goods imported by MHI, many were from product lines not selected for U.S. marketing by MHI and Herendi.[22]

MHI and Herendi filed suit in the United States District Court for the Southern District of Texas alleging trademark infringement and false designation of origin under the Lanham Act.[23] The complaint alleged that Juhasz sold counterfeit goods, and the president of MHI filed an accompanying affidavit stating that MHI had purchased counterfeit goods from Juhasz.[24] Based on this limited evidence, the court granted a temporary restraining order and issued an ex parte order of seizure.[25] Pursuant to this order, plaintiff's counsel, assisted by U.S. marshals, conducted a raid of

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18 *See id.*

19 *See id.*

20 *See id.* Although MHI and Herendi alleged that Juhasz had imported counterfeit goods, Juhasz "vehemently maintained throughout this litigation that it only sold genuine Herend porcelain, purchased from legitimate sources in this country or elsewhere. It claim[ed] that all the goods it sold bore a true Herendi trademark and were in fact manufactured at the Herendi factory." *Id.* The district court, however, decided the issue of infringement not on the theory that the infringing goods were counterfeit, but on a theory that they were materially different from authorized imports. Thus, the Fifth Circuit assumed that Juhasz had imported only genuine goods bearing a valid U.S. trademark. *See id.* at 1301 ("As in our case, the goods at issue in *Nestle* were authentic and bore a genuine trademark.").

21 *See id.* at 1299.

22 *See id.* at 1302 (noting that "[s]ome of the pieces, such as figurines of guinea hens and rabbits, were completely different pieces from those sold by [MHI]"). Frank Juhasz admitted that more than 50% of the Herendi goods sold by Juhasz were not also sold by Martin's Imports. *See id.*

23 *See id.* at 1299. *See generally infra* Part III.A. (discussing the Lanham Act and trademark infringement).

24 *See id.*

25 *See id.*

Juhasz's premises and seized "numerous goods and records."[26] Juhasz then filed a counterclaim for wrongful seizure.[27]

At trial, the district court granted summary judgment to the plaintiffs on their Lanham Act claims and on the defendant's wrongful-seizure counterclaim.[28] The court issued a permanent injunction against Juhasz and accepted a jury verdict awarding plaintiffs $685,000 in damages.[29] The court further awarded the plaintiffs attorney's fees in the amount of $328,825.[30] After trial, the court found Juhasz was violating the permanent injunction, for which it issued a severe contempt order.[31] Juhasz appealed to the Fifth Circuit, challenging the five primary holdings of the district court: (1) the grant of summary judgment on the issue of infringement; (2) the award of damages; (3) the award of attorney's fees; (4) the grant of summary judgment on the wrongful-seizure counterclaim; and (5) the contempt order.[32]

### *B. Fifth Circuit Holding*

#### *1. Infringement*

The Fifth Circuit modified the district court's ruling on the infringement issue as if the goods sold by Juhasz were genuine

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[26] *Id.*

[27] *See id.* at 1300.

[28] *See id.*

[29] *See id.*

[30] *See id.* at 1305.

[31] *See id.* at 1306. The contempt order required Juhasz to:

> return all physically different Herend products and all related brochures, price lists and other advertising materials; (2) turn over records documenting the sale of physically different products, so that plaintiffs could in the future seek recovery for lost revenues; (3) identify and send a letter to all persons who had received physically different products or advertising for such products, stating that defendants sold them in violation of the injunction; (4) pay plaintiffs $6300 as reasonable attorney's fees in bringing the contempt proceeding; (5) serve within 12 days a declaration describing its compliance with the contempt order; and (6) beginning 10 days after entry of the contempt order, pay a fine of $50 per day for each day of non-compliance with the order.

*Id.* at 1306-07.

[32] *See id.* at 1299.

goods bearing a valid U.S. trademark.[33] The Fifth Circuit noted that, in this situation, courts have found infringement where the "the goods sold by the authorized domestic distributor and the defendant's foreign goods are materially different . . . ."[34] The court adopted this test and applied it to the goods sold by Juhasz.[35]

In its opinion, the Fifth Circuit first noted that the goods sold by Juhasz were not all offered for sale in the United States by MHI.[36] The court also focused on the luxurious character of the HEREND products and appeared to limit its holding to cases involving luxury goods by stating that the material differences test "is a sound one, at least when the goods are highly artistic, luxury goods."[37] The court reasoned that marketing artistic goods is a delicate matter, and trademarks used in connection with such goods therefore should be given greater protection.[38] In addition, it characterized the exclusive distributorship agreement with MHI as a manifestation of Herendi's control over its mark.[39]

In light of the sensitive nature of the HEREND trademark, the Fifth Circuit elaborated on the stylistic differences between the authorized goods and some of the gray goods, noting that some of the figurines sold by Juhasz were completely different shapes than those sold by MHI, while others were painted with different patterns and colors.[40] The court held that these differences were material as a matter of law because "consumer choices for such artistic pieces are necessarily subjective or even fanciful,

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33 *See id.* at 1300-01.

34 *Id.* at 1301-02. The Fifth Circuit refers to this test as the *Nestle/OAA* test, citing *Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.*, 982 F.2d 633 (1st Cir. 1992), and *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.*, 816 F.2d 68 (2d Cir. 1987). *See Martin's Herend Imports*, 112 F.3d at 1301. For further discussion of these cases, see *infra*, Part III.B.

35 *See Martin's Herend Imports*, 112 F.3d at 1301-02.

36 *See id.* at 1302.

37 *Id.*

38 *See id.* The court noted that "[f]or Herendi, maintaining the goodwill of its mark may depend on the stores where the goods are sold, advertising, the selection of which of the thousands of Herendi pieces will be offered for sale in this country, and many other factors." *Id.*

39 *See id.*

40 *See id.*

depending on each consumer's personal artistic tastes."[41]

Having established liability for infringement, the Fifth Circuit proceeded to consider two arguments advanced by Juhasz in defense of its gray market activity. The court first rejected the merit of Juhasz's argument that its goods were the same grade and quality as the goods sold by MHI.[42] The court held that identical quality was not a defense, stating that "the plaintiff need not prove that the defendant's imports are of inferior quality to establish trademark infringement, only that they are materially different."[43]

The Fifth Circuit also rejected Juhasz's second argument, that the first sale doctrine completely protects its activities.[44] It noted that generally a buyer may resell genuine goods bearing a valid trademark without incurring trademark liability.[45] However, the court reasoned that this doctrine cannot be the controlling principle in the context of an unauthorized gray-market importer.[46] The court observed that, otherwise, all gray-market importers would escape liability because "unauthorized importers are never the first seller."[47] Furthermore, the court recognized that prior case law defining the doctrine of gray market goods can not be reconciled with such a broad reading of the first sale doctrine.[48]

Although the Fifth Circuit declined to apply the first sale rule to reverse the district court's finding of infringement, Juhasz's efforts in advancing this argument were not completely unsuccessful.[49] The Fifth Circuit held that the underlying

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[41] *Id.* The court quoted Juhasz's argument that "'each consumer for a variety of reasons might prefer a bird to a rabbit or stripes to diamonds or red to blue.'" *Id.*

[42] *See id.*

[43] *Id.*

[44] *See id.* at 1303.

[45] *See id.*

[46] *See id.*

[47] *Id.*

[48] *See id.* "[A]pplying the first sale rule to an unauthorized importer . . . would mean the gray-market importer would always escape liability. Unauthorized importers are *never* the first seller . . . . Yet since 1923 . . . courts have held that such sales can sometimes violate the trademark laws." *Id.* For a discussion of prior case law, see *infra* notes 82-96 and accompanying text.

[49] *See id.* at 1304.

principles behind the first sale doctrine[50] are properly considered in a gray market case and that these should apply to limit the scope of the permanent injunction issued against Juhasz.[51] Thus, the Fifth Circuit modified the district court's injunction "to allow Juhasz to sell all pieces which have ever been sold by the plaintiffs in the United States."[52] This limitation reflects a balance drawn by the court between the first sale doctrine and the territorial integrity of a trademark where the trademark owner has sanctioned the sale of a particular product in a territory.[53] As the court noted: "In such circumstances the first sale rule's policies of limiting restraints on trade and alienation of personal property outweigh the trademark owner's right to control its goodwill through an exclusive distributorship arrangement."[54]

*2. Damages*

The Fifth Circuit affirmed the award of damages against Juhasz in its entirety, noting the district court has broad discretion in awarding damages under the Lanham Act.[55] While the award of damages was based on the testimony of experts who relied on inconsistent evidence,[56] the court nonetheless affirmed the damages award because the trial court had the discretion to change it as appropriate.[57]

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[50] The underlying rationale for the first sale doctrine is that, after the first sale of the product, the need to protect the trademark owner's rights in the mark gives way to public policy disfavoring restraints on the alienation of personal property. *See id.* at 1303.

[51] *See id.* at 1304.

[52] *Id.* The court also made it clear that it did not matter if Juhasz sold a particular piece in the United States first, as long as at some point in time, MHI also sold that piece in the United States. *See id.* Thus, the court stated that "[a]s long as plaintiffs have ever approved a piece for importation and sale in this county, Juhasz is free to sell any individual piece of the same quality from the same product line." *Id.*

[53] *See id.*

[54] *Id.*

[55] *See id.* Under the Lanham Act, the trial court may increase the award of damages up to three times the amount found as actual damages. *See* 15 U.S.C. § 1117(a) (1994); *Martin's Herend Imports*, 112 F.3d at 1304.

[56] *See Martin's Herend Imports*, 112 F.3d at 1305.

[57] *See id.*

### 3. *Attorney's Fees*

The Fifth Circuit reversed the award of plaintiff's attorney's fees in this case.[58] The court noted that the Lanham Act only allows for attorney's fees in "exceptional" cases.[59] As the court noted, cases that are exceptional usually involve malicious, fraudulent, deliberate, or willful conduct on the part of the defendant.[60] Because there was no evidence in this case that Juhasz knew its actions were illegal, the award of attorney's fees could not be sustained.[61] Furthermore, the court pointed out that the uncertainty in the law of gray market goods made this a particularly unsuitable case for an award of attorney's fees.[62]

### 4. *Wrongful-Seizure Counterclaim*

The Fifth Circuit also reversed the entry of summary judgment on the wrongful seizure counterclaim.[63] The order of seizure was issued pursuant to section 34 of the Lanham Act.[64] Because of the "draconian nature" of the seizure remedy, however, the court held that it must be construed narrowly and cannot be read to authorize the seizure of gray market goods.[65] The court noted that section 34 specifically exempts goods to which a mark is affixed by a manufacturer authorized to use the mark.[66] Because the plaintiffs never established that Juhasz had sold any counterfeit goods, the district court erred in granting summary judgment on Juhasz's

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[58] *See id.*

[59] *See id.*; 15 U.S.C. § 1117(a) (1994).

[60] *See Martin's Herend Imports*, 112 F.3d at 1305 (citing Texas Pig Stands, Inc. v. Hard Rock Cafe Int'l, Inc., 951 F.2d 684, 697 (5th Cir. 1992)).

[61] *See id.*

[62] *See id.* The court noted that even the district court erred in granting an overly broad injunction and that "[t]he notion that a jeweler can violate the trademark laws by importing and selling genuine porcelain with a genuine trademark borders on the counterintuitive, even to those seasoned in the law." *Id.*

[63] *See id.* at 1306.

[64] *See id.* at 1305. Section 34 of the Lanham Act is codified at 15 U.S.C. § 1116 (1994).

[65] *See id.* at 1306.

[66] *See id.*

counterclaim for wrongful seizure.[67]

### 5. *Contempt Order*

Finally, the Fifth Circuit upheld the trial court's contempt order, despite the fact that the underlying permanent injunction was overly broad.[68] The court noted that the contempt order was issued for civil rather than criminal contempt,[69] and as such, the trial court was not required to find beyond a reasonable doubt that Juhasz violated the injunctive order.[70] In addition, it held that the trial court did not abuse its discretion in issuing the order because the findings of fact underlying the contempt order were not clearly erroneous.[71] Further, the injunction was not so vague that Juhasz could have misunderstood its requirements.[72]

The Fifth Circuit's decision in *Martin's Herend Imports* illuminates some new pitfalls in the area of gray market goods. First, the decision illustrates the difficulty courts can have in applying Lanham Act remedies in gray market cases. Second, the court's decision warns potential gray market defendants that the material difference standard may be controlled by the trademark owner rather than the gray market defendant. Finally, the court's decision cautions gray market plaintiffs that their own territorial marketing decisions may circumscribe remedies available under the Lanham Act against a gray market infringer. The significance of these new pitfalls in the law of gray market goods is apparent in the context of earlier gray market cases and the Lanham Act itself.

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[67] *See id.*

[68] *See id.* at 1307. The court quoted the Supreme Court in noting that "'a contempt proceeding does not open to reconsideration the legal or factual basis of the order alleged to have been disobeyed' . . . ." *Id.* (quoting Maggio v. Zeitz, 333 U.S. 56, 69 (1948)).

[69] *See id.*

[70] *See id.*

[71] *See id.*

[72] *See id.*

## III. Background Law

### *A. The Lanham Act and Trademark Infringement*

The statutory foundation of American trademark law is the Lanham Trademark Act.[73] Trademark owners who wish to bar gray market imports generally bring Lanham Act claims for infringement, importation of goods bearing infringing marks, and unfair competition.[74] Section 32 of the Lanham Trademark Act[75] protects registered marks from infringement, providing that:

> Any person who shall, without the consent of the registrant—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 consumer confusion* or to cause mistake, or to deceive ... shall be liable in a civil action by the registrant . . . .[76]

Thus, the touchstone of trademark infringement is the "likelihood of consumer confusion" test.[77] Without a finding that consumers are likely to be confused by an allegedly infringing use, a plaintiff cannot recover for trademark infringement. This is the animating principle in any infringement action, even under the law of gray market goods.

Section 43(a) of the Lanham Act[78] provides a civil right of action to anyone who is damaged by unfair competitive practices,

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[73] 15 U.S.C. §§ 1051-1127 (1994).

[74] Trademark owners domiciled in the United States may also use the customs laws to exclude gray market goods. *See infra* note 81 (discussing 19 U.S.C. § 1526). Presumably, this course of action was not pursued in *Martin's Herend Imports* because the U.S. registration and ownership of the Herend trademark were in Herendi, a Hungarian corporation.

[75] 15 U.S.C. § 1114 (1994).

[76] *Id.* § 1114(1)(a) (emphasis added).

[77] *See* Polaroid Corp. v. Polarad Elecs. Corp., 287 F.2d 492, 495 (2d Cir.) (originating a multi-factor test for likelihood of confusion), *cert. denied*, 368 U.S. 820 (1961). *See also, e.g.*, Ferrari S.P.A. Esercizio Fabriche Automobili E Corse v. Roberts, 944 F.2d 1235 (6th Cir. 1991); Lois Sportswear v. Levi Strauss & Co., 799 F.2d 867 (2d Cir. 1986); Frisch's Restaurant, Inc. v. Elby's Big Boy, 670 F.2d 642, 648 (6th Cir.), *cert. denied*, 459 U.S. 916 (1982).

[78] 15 U.S.C. § 1125 (1994).

including false designations of origin. This section provides, in relevant part:

> Any person who, on or in connection with any goods or services, or any container for goods, uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representations of fact, which—
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> (1) is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person . . .
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> . . .
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> shall be liable in civil action by any person who believes that he or she is or is likely to be damaged by such act.[79]

It is noteworthy that a likelihood of confusion is required for liability under section 43.

Section 42 of the Lanham Act[80] prohibits the importation of goods bearing counterfeit marks or false designations of origin. This section provides, in relevant part:

> [N]o article of imported merchandise which shall copy or simulate the name of . . . any domestic manufacture, or manufacturer, or trader, or of any manufacturer or trader located in any foreign country which, by treaty, convention, or law affords similar privileges to citizens of the United States, or which shall copy or simulate a trade-mark [sic] registered in accordance with the provisions of this Act or shall bear a name or mark calculated to induce the public to believe that the article is manufactured in the United States or that is manufactured in any foreign country or locality other than the country or locality in which it is in fact manufactured, shall be admitted to entry at any customhouse of the United States . . . .[81]

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[79] *Id.* § 1125(a) (1994).

[80] *Id.* § 1124 (1994).

[81] *Id.* The importation of gray market goods is also regulated by section 526 of the Tariff Act of 1930, 19 U.S.C. § 1526 (1994). *See* K Mart Corp. v. Cartier, Inc., 486 U.S. 281 (1988). Section 1526 prohibits the importation of goods bearing a registered mark owned by a person domiciled in the United States if a copy of the certificate of

Section 42 pointedly addresses imported goods bearing infringing marks. It does not, however, address when goods are infringing. Thus, section 42 must be read in light of sections 32 and 43, which define infringement and false designations of origin.

*B. Gray Market Goods: A Twentieth-Century Phenomenon*

The law of gray market goods reflects the territorial dimension of trademark law.[82] Prior to the twentieth century, trademark law did not address the fact that goods bearing marks may cross national borders. Indeed, the origin of territoriality in U.S. trademark law is found in a 1923 Supreme Court case, *A. Bourjois & Company v. Katzel*.[83] In *Katzel* the plaintiff, an American corporation, had purchased a French company's face powder business in the United States as well as its registered trademarks used in connection with the face powder.[84] After re-registering the marks in its own name, the plaintiff continued to import the French company's face powder.[85] The plaintiff marketed the face powder in boxes which bore the mark POUDRE JAVA and which disclosed the plaintiff's relationship to the French company.[86] The defendant imported the French face powder and marketed it in the original French boxes, which bore the mark POUDRE RIZ DE JAVA.[87] The Court held that the defendant had infringed the trademark rights of the plaintiff even though the defendant sold

registration is filed with the Secretary of the Treasury and written consent of the owner is not produced at the time of entry. *See* 19 U.S.C. § 1526(a) (1994). Such goods are subject to seizure. *See id.* § 1526(b) (1994). For further discussion of § 1526, see Jane A. Restani, *An Introduction to the Gray Market Controversy*, 13 BROOK. J. INT'L L. 235, 236 (1987). In *K Mart*, the Supreme Court evaluated Treasury regulations enforcing § 1526. *See K Mart*, 486 U.S. at 292-94. For further commentary on the *K Mart* decision, see Shubha Ghosh, *An Economic Analysis of the Common Control Exception to Gray Market Exclusion*, 15 U. PA. J. INT'L BUS. L. 373 (1994); Donna M. Lach, *The Gray Market and the Customs Regulation—Is the Controversy Really Over After* K Mart Corp. v. Cartier, Inc.*?*, 65 CHI.-KENT L. REV. 221 (1989).

[82] *See generally* Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F.2d 633, 636-37 (1st Cir. 1992).

[83] 260 U.S. 689 (1923).

[84] *See id.* at 690.

[85] *See id.* at 690-91.

[86] *See id.* at 691.

[87] *See id.*

only genuine face powder.[88] The Court reasoned that the French manufacturer could not have circumvented its lawful assignment of trademark rights to the plaintiff by conspiring with a third party to bring the face powder into the United States.[89] Thus, the Court concluded that "the vendors could not convey their goods free from the restriction to which the vendors were subject."[90] Thus, the defendant, in purchasing from the French manufacturer, did not acquire the right to sell the goods in the United States with the mark affixed by the French manufacturer.[91] The Court further supported its holding by recognizing the territorial integrity of the plaintiff's trademark:

> It is said that the trade mark here is that of the French house and truly indicates the origin of the goods. But that is not accurate. It is the trade mark of the plaintiff only in the United States and indicates in law, and, it is found, by public understanding, that the goods come from the plaintiff although not made by it.[92]

The Court derived the territoriality principle from the nature of trademark as a shorthand for the goodwill of the trademark owner.[93] The *Katzel* Court thus recognized trademark owners may create distinct reputations in particular geographic regions, and trademark rights are to some extent defined by national borders.

Since *Katzel*, many lower federal courts have recognized the territoriality of trademarks.[94] Other courts, however, have been

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88 *See id.*

89 *See id.* at 691-92.

90 *Id.* at 692.

91 *See id.*

92 *Id.*

93 *See id.* ("[The trademark] stakes the reputation of the plaintiff on the character of the goods.").

94 *See, e.g.*, Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F.2d 633, 636-37 (1st Cir. 1992) ("Without such territorial trademark protection, competitors purveying country-specific products could exploit consumer confusion and free ride on the goodwill of domestic trademarks with impunity."); Lever Bros. Co. v. United States, 877 F.2d 101, 107 (D.C. Cir. 1989) (Lever I) (noting that the territoriality principle applies where two merchants sell physically different products in the same geographic market under the same name); Original Appalachian Artworks, Inc. v. Granada Elecs., Inc., 816 F.2d 68, 71 (2d Cir. 1987) (noting that trademark holder may pursue remedies against a gray market importer under § 526 of the Tariff Act of 1922 (codified at 19 U.S.C. § 1526 (1982)) notwithstanding failure of customs officials to exclude gray

hostile to this extension of trademark rights.[95] This tension has led courts to seek a guiding principle to define the territoriality concept and to ground the law of gray market goods in the fundamentals of trademark law.[96]

### C. *The Material Differences Standard*

In order to bring the law of gray market goods into accord with the policies driving trademark law, the federal courts, in the 1980s and early 1990s, devised a standard of product equivalence as a proxy for the likelihood of confusion test.[97] This approach was first taken by the district court in *Osawa & Co. v. B & H Photo*.[98] In that case, the court held that differences in point-of-sale servicing resulted in irreparable injury to the trademark holder.[99] Although the defendant sold only genuine MAMIYA cameras under the plaintiff's mark, it did not provide warranty service,

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market goods (citing Olympus Corp v. United States, 792 F.2d 315, 320 (2d Cir. 1986))), *cert denied*, 484 U.S. 847 (1987); Osawa & Co. v. B & H Photo, 589 F. Supp. 1163, 1173 (S.D.N.Y. 1984) ("[A] mark may have not only a separate legal basis but also a different factual significance in each separate country where the local mark owner has developed an independent goodwill.").

95 *See, e.g.*, Weil Ceramics & Glass, Inc. v. Dash, 878 F.2d 659, 668-69 (3d Cir.) ("*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."), *cert. denied*, 493 U.S. 853 (1989); NEC Elecs. v. CAL Circuit ABCO, 810 F.2d 1506, 1509 (9th Cir.) (quoting Champion Spark Plug Co. v. Sanders, 331 U.S. 125, 128 (1947) to limit *Katzel* to situations where the defendant "market[s] goods 'of one make under the trademark of another'"), *cert. denied*, 484 U.S. 851 (1987).

96 *See, e.g.*, *Societe Des Produits Nestle*, 982 F.2d at 637 ("[T]erritoriality only goes so far . . . . [C]ourts do not read *Katzel* . . . to disallow the lawful importation of *identical* foreign goods carrying a valid foreign trademark.").

97 *See generally* Lipner, *supra* note 1, at 1034. In the early 1980s, federal courts generally refrained from applying trademark law to prohibit the importation of gray market goods. *See id.* The courts gave two reasons for this position:

> The first rationale is that once the goods are introduced into the stream of commerce by the foreign markholder, its rights to control the goods, and the rights of its close corporate affiliates to control the goods through its U.S. trademark rights, are exhausted. Another rationale is that the goods are genuine and the sale of genuine goods cannot cause consumer confusion as to source.

*Id.* (footnotes omitted).

98 589 F. Supp. 1163 (S.D.N.Y. 1984).

99 *See id.* at 1165-70.

product education, an inventory of peripheral equipment, or a continuing buyer-seller relationship of service and advice.[100] The failure to provide these services, which were provided by authorized dealers of MAMIYA cameras, created a likelihood of consumer confusion which caused irreparable injury to the trademark owner.[101]

Product differences also played a key role in *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.* (*OAA*).[102] In *OAA*, the Second Circuit held that Cabbage Patch dolls intended for a foreign market could not be imported into the United States because of significant differences between the foreign dolls and the American dolls.[103] For example, the foreign dolls contained birth certificates and adoption papers that were not in English.[104] Furthermore, the American dolls could be adopted through United States fulfillment houses, which would also send birthday cards to purchasers of the American dolls.[105] Purchasers of the foreign dolls could not take advantage of these services.[106] The court found that these differences "create[d] . . . confusion over the source of the product and result[ed] in a loss of OAA's and Coleco's good will."[107] The court likened the facts of the case to *Osawa*, where the trademark owner's goodwill was similarly being damaged by consumer confusion.[108]

Five years after *OAA*, in *Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.*,[109] the First Circuit synthesized a test for

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[100] *See id.* at 1165-67.

[101] *See id.* at 1168-69. In earlier litigation involving the plaintiff, the Second Circuit required a showing of irreparable injury prior to barring the import of gray market goods. *See* Bell & Howell: Mamiya Co. v. Masel Supply Corp., 719 F.2d 42, 46 (2d Cir. 1983).

[102] 816 F.2d 68 (2d Cir.), *cert. denied*, 484 U.S. 847 (1987).

[103] *See id.* at 73.

[104] *See id.*

[105] *See id.*

[106] *See id.*

[107] *Id.*

[108] *See id.*; *see also supra* notes 97-101 and accompanying text.

[109] 982 F.2d 633 (1st Cir. 1992).

infringement in gray market cases based on product differences.[110] The case involved the sale of chocolates in Puerto Rico under the trademark PERUGINA.[111] This mark was owned by the plaintiff, Societe Des Produits Nestle, S.A. (Nestle S.P.N.), which authorized its affiliate Nestle Puerto Rico to market Italian-made chocolates in Puerto Rico.[112] The defendant, however, imported chocolates manufactured by a Venezuelan company under license from Nestle S.P.N.[113] These Venezuelan chocolates differed from the Italian chocolates in presentation, variety, composition, and price.[114] The plaintiff filed a trademark infringement action which the district court denied.[115]

In considering Nestle S.P.N.'s appeal, the First Circuit began by stating that "any difference between the registrant's products and the allegedly infringing gray goods 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."[116] The First Circuit noted that a gray market defendant could rebut this presumption by showing that the product differences "are not of the kind that consumers, on average, would likely consider in purchasing the product."[117] Because the product differences noted by the court could undermine consumer expectations and very well lead to consumer

[110] *See id.* at 640-41.

[111] *See id.* at 635.

[112] *See id.*

[113] *See id.*

[114] *See id.* The court cataloged these differences later in its opinion. *See id.* at 642-43. First the court noted that the shipping and handling procedures, including product inspection procedures, were markedly different between the authorized distributor and the defendant. *See id.* at 642. Also, the Italian-made version of one variety of chocolates contained five percent more milk fat than the Venezuelan chocolates, and other ingredients differed between the two products. *See id.* The court also noted that the Italian chocolates came in a greater variety of shapes. *See id.* The packaging of the two products differed in color, finish, illustration, and description. *See id.* at 643. Finally, the court noted that the price of the products differed substantially. *See id.*

[115] *See id.* at 635-36.

[116] *Id.* at 641.

[117] *Id.*

confusion, the court presumed the differences to be material.[118] Since the defendant presented no evidence to show that the consumers did not consider these differences relevant or that retailers explained the differences to consumers, the court reversed the denial of plaintiff's trademark infringement claims.[119]

Both the *OAA* and *Nestle* cases clearly outlined a material differences standard which the Fifth Circuit could have adopted for its analysis in *Martin's Herend Imports*.[120] The Second Circuit in *OAA* found that in order to find genuine gray goods infringed a plaintiff's mark, the gray goods must differ from the authorized goods such that consumers could be confused or disappointed by the goods.[121] And the First Circuit in *Nestle* defined a material difference as one in which a consumer would find relevant in making the purchasing decision.[122] However, the Fifth Circuit forged its own path, seemingly electing to adopt instead a much broader definition that encompasses any product difference.

## IV. Significance of the Case

The Fifth Circuit interpreted the material differences standard to include stylistic choices made by the trademark owner and its exclusive domestic distributor. This holding undermines the purpose behind the material differences standard itself, which is intended to place reasonable limits on the territoriality of trademark law.[123] The real weakness in the court's decision in *Martin's Herend Imports*, therefore, is the court's failure to look at the significance of the stylistic differences to determine if there was a real risk of consumer confusion. Consequently, the American consumer was denied product choice because of an overly broad application of trademark law. This anticompetitive

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[118] *See id.* at 643-44.

[119] *See id.* at 644.

[120] *See Martin's Herend Imports, Inc.*, 112 F.3d at 1300-01.

[121] *See supra* notes 102-19 and accompanying text.

[122] *See Nestle*, 982 F.2d at 641.

[123] *See* Lipner, *supra* note 1, at 1033-34 ("As courts continue to draw rational lines concerning the degree of gray market competition which will be permissible, they must determine the level of difference between gray market goods and authorized goods which will be tolerated.").

result should caution courts to enforce the material differences standard in a more meaningful way.[124]

*A. Material Differences Standard Undermined*

The decision in *Martin's Herend Imports* undermines the material differences standard by dissipating the significance of materiality. The plaintiff in this case was able to demonstrate only that the defendant had imported genuine Herend figurines of different styles and color patterns than those of the authorized distributor.[125] In response, the defendant sought to show that a consumer would not be confused by the different shapes and color patterns.[126] The defendant argued that because this case is distinguishable from both *Nestle* and *OAA*, the stylistic differences were obvious to the consumer and there were no hidden differences that would be lost to the consumer because of a reliance on the trademark.[127] Nevertheless, the court rejected this argument, holding stylistic differences are material in the context of luxury goods.

In both *Nestle* and *OAA*, consumers relied on the trademark both as a symbol of goodwill and as an indication of certain product traits. In *Nestle*, the Puerto Rican consumer relied on the PERUGINA mark as a symbol of quality, composition, configuration, and variety.[128] In *OAA*, the American consumer relied on the CABBAGE PATCH mark as a symbol of the ability to "adopt" the doll and to receive a birthday card.[129] The defendants' goods in both of these cases to some extent preyed on this reliance to the detriment of the consumer and the trademark owner.

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[124] *See id.* at 1054 ("If trademark law is used to enjoin gray market sales without proof that the gray market goods are substantially different from the authorized goods, trademark law will have the effect of suppressing competition rather than protecting trademark rights and goodwill. Courts should strive to avoid such an interpretation of the law.").

[125] *See Martin's Herend Imports,* 112 F.3d at 1302.

[126] *See id.*

[127] *See id.*

[128] *See Nestle,* 982 F.2d 633, 643-44.

[129] *See* Original Appalachian Artworks, Inc. v. Granada Elecs., Inc., 816 F.2d 68, 73 (2d Cir. 1987).

In contrast to the consumer reliance in *Nestle* and *OAA*, the consumers of Herend porcelain did not rely on the HEREND mark for their stylistic choice. Rather, these consumers relied on the mark for a level of quality in the porcelain figurines. The defendant Juhasz did not prey on this expectation but fulfilled it by selling only genuine Herend products. For this reason, the gray goods in this case are much like the situation of identical goods described by the court in *Nestle*: "In such a situation, consumers get exactly the bundle of characteristics that they associate with the mark and the domestic distributor can be said to enjoy in large measure his investment in goodwill."[130] Thus, neither the consumer nor the trademark owner's local goodwill were injured by Juhasz's activity. The remaining question is whether the Fifth Circuit's decision is consistent with trademark law.

*B. Reason on the Run: Trademark Law Out of Control*

The only rationale which can support the Fifth Circuit's decision in *Martin's Herend Imports* is the protection of a trademark owner's right to control its goodwill by territories.[131] The rationale goes something like this: if Herendi and MHI are unable to exclude certain styles from the U.S. market, they will be unable to shape the perception of their mark by the American consumer. While the courts should be sensitive to this interest, it should not be dispositive of the issue of trademark infringement. This interest must yield to the consumer's interest in product choice free of anticompetitive restrictions on gray market goods. If the gray market importer can give the consumer a style not made available by the trademark owner, this makes the market more competitive.[132] The benefit of this competition should not be denied to the consumer merely to protect a trademark owner's

130 *Nestle*, 982 F.2d at 641.

131 As a general matter, the issue of goodwill should be viewed in light of the first sale rule and the fact that the trademark owner has already benefited from its goodwill to the extent that the gray market importer has already paid a market price (albeit a foreign market price) for the goods. *See generally Martin's Herend Imports*, 112 F.3d at 1303.

132 Based on a consumer choice theory, it is arguable that the *OAA* decision is wrong. There are certainly Spanish-speaking consumers in the American market. Perhaps these consumers would have been pleased to find a Cabbage Patch doll which contained Spanish adoption papers and instructions.

control of consumer perception. At the very least, a court should find material only those differences which could result in irreparable harm to the trademark owner.[133]

Another problem that results from the Fifth Circuit's reasoning is a conflict with the first sale doctrine.[134] The court addressed the first sale doctrine by noting that "applying the first sale rule to an unauthorized importer such as Juhasz would mean that the gray-market importer would always escape liability."[135] By vaguely asserting that *Katzel* is inconsistent with this result,[136] the Fifth Circuit distorted the relationship between gray market goods and the first sale doctrine. Contrary to the court's position, these areas of trademark law are not unrelated. Rather, they are related through a meaningful application of the material difference standard. A gray market importer who imports goods which do not materially differ from the authorized goods should be protected by the first sale doctrine.[137]

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133 *Cf.* Lipner, *supra* note 1, at 1053-54. Professor Lipner proposes a differentness test which considers the probability of harm to the trademark owner and the seriousness of such harm:

> This proposed test addresses the full panoply of gray market cases. For example, consumers are unlikely to feel grave disappointment if a two-dollar battery fails to live up to expectations. If clothing or shoes are defectively manufactured and fall apart after a short period of use, consumer anger is more likely to increase or decrease based upon the price paid, the existence of a discount from the "authorized" price, whether the defect was disclosed or was discoverable at the point of purchase, and whether a refund can be obtained from the retailer. The existence of European or metric sizing, for example, should not be considered a material difference between gray market goods and trademarked goods, primarily because it is readily discoverable upon a visual inspection.

*Id.* at 1053 (footnotes omitted).

134 The first sale doctrine generally restricts a trademark owner from pursuing an infringement action against a purchaser of its goods that resells those goods. *See* NEC Elecs. v. CAL Circuit ABCO, 810 F.2d 1506, 1509 (9th Cir. 1987) ("Once a trademark owner sells his product, the buyer ordinarily may resell the product under the original mark without incurring any trademark law liability.").

135 *Martin's Herend Imports*, 112 F.3d at 1303.

136 *See id.*

137 *Cf. NEC Elecs.*, 810 F.2d at 1509-10 (using the first sale doctrine as the foundation for its gray market analysis and restricting *Katzel* to the particular facts of that case in holding that a gray market importer of computer chips did not infringe on a trademark).

The relationship of the first sale doctrine to the gray market reflects considerations which mitigate absolute protection from gray market imports under trademark law. First, the trademark owner benefits from the original purchase of the gray market goods.[138] This fact demands consideration of whether a trademark owner can protect the territoriality of its goodwill through its own efforts. A trademark owner can protect its own interest in territoriality by monitoring its distribution policies abroad[139] or by developing different trademarks in different countries.[140] The court did not consider these possibilities in *Martin's Herend Imports*.

The Fifth Circuit, by finding stylistic differences material, undermined the material differences standard as a limit on the territoriality of trademarks. By doing so, the court sanctioned an anticompetitive result which reduced consumer choice in the market for Herend porcelain. The Ninth Circuit declined to allow a similar result in *NEC Electronics*: "This country's trademark law does not offer NEC-Japan a vehicle for establishing a worldwide discriminatory pricing scheme simply through the expedient of setting up an American subsidiary with nominal title to its mark."[141]

## V. Conclusion

As Professor Lipner has noted: "Courts, as a rule, have been too hasty to enjoin sales based upon minor, or even non-existent

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138 *See supra* note 50.

139 A policy of selling goods intended for non-U.S. markets only to wholesale distributors who agree to sell only to non-U.S. retailers could have curtailed Juhasz gray market activity or at least raised the cost of purchasing the gray market goods.

140 *See generally* Weil Ceramics & Glass, Inc. v. Dash, 878 F.2d 659, 683 (3d Cir. 1989) (Becker, J., concurring). In *Weil*, Judge Becker noted that

> [t]o protect Weil's interest in its American trademark, Weil's parent, Lladro, could affix different trademarks to each corresponding level of quality, different trademarks to those products imported into the United States by Weil and those sold elsewhere in the world, and/or inform the public of the differences in quality, thereby precluding the possibility of deception or confusion.

*Id.* (Becker, J., concurring). By analogy, Herendi could have affixed a different mark to styles intended for the U.S. market. This course of action would have prevented Juhasz from acquiring goods only intended for foreign markets with an American trademark attached.

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

differences."[142] The Fifth Circuit followed this pattern in *Martin's Herend Imports*. The court did not consider the real significance of the stylistic differences between the authorized and unauthorized imports. There was certainly no likelihood of confusion as to source. Indeed, the figurines originated from the same Herendi factory in Hungary. Furthermore, it is unlikely that a consumer would be confused by the shape or color patterns on a Herend figurine prior to purchase. Thus, there was little chance of irreparable injury to Herendi's goodwill. Finally, Herendi may have been able to protect the territoriality of its goodwill through its own efforts.

In light of its somewhat attenuated reasoning, the Fifth Circuit's opinion can most generously be read to protect Herendi's goodwill in the American market. The more realistic view, however, is that the Fifth Circuit applied the material difference test without judging whether any of the stylistic differences are material. The result of this fast and loose approach to the gray market was a detrimental reduction in choice for the American consumer, a result which courts should be careful to avoid.

ARIF S. HAQ

[142] Lipner, *supra* note 1, at 1052.