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K MART V. CARTIER: THE SUPREME COURT DECIDES THE GRAY MARKET PROBLEM

R. RICHARD HOPP*

I.

In 1921 the Second Circuit Court of Appeals decided *Bourjois & Co. v. Katzel*.¹ In that case the plaintiff purchased the exclusive right to sell the face powder "Java" in the United States from the French manufacturer of the powder. The defendant, an owner of a small drug store, imported the genuine face powder from the French company and began to sell it in competition with the plaintiff. The plaintiff argued that the defendant was infringing on his United States registered trademark. Properly grounded in the trademark theory of the time, the Second Circuit denied protection to the plaintiff, holding:

Trade-marks . . . are intended to show without any time limit the origin of the goods they mark, so that the owner and the public may be protected against the sale of one man's goods as the goods of another man. *If the goods sold are the genuine goods covered by the trade-mark, the rights of the owner of the trade-mark are not infringed.*²

Rejecting the circuit court's theory that the trademark "Java" indicated only that the face powder came from the French company, the Supreme Court reversed.³ The Court held that the mark not only indicated the source of the face powder as French, but that "[i]t is the trade mark of the plaintiff only in the United States and indicates in

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1. 275 F. 539 (2nd Cir. 1921).

2. *Id.* at 543 (emphasis added). This decision is based on the "source theory" of trademarks which regards the purpose of trademarks solely to protect the consumer from counterfeits. In *Apollinaris Co. v. Scherer*, 27 Fed. 18, 20 (1886), the court held:

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

3. *Bourjois & Co. v. Katzel*, 260 U.S. 689 (1923).

law, and, it is found, by public understanding, that the goods come from the plaintiff although not made by it."⁴ In addition, the Court considered a trademark's purpose as more than denoting source, but also as a valuable asset of the plaintiff's business.⁵ Trademark rights are "a delicate matter that may be of great value but that [are] easily . . . destroyed, and therefore should be protected with corresponding care."⁶ The value of a trademark was identified by the Supreme Court as the good will of plaintiff's business as well as the "reputation he stakes upon the character of the goods."⁷

Not only the Supreme Court, but also Congress, recognized the inequities involved in denying *Bourjois & Co.* protection for the rights it purchased from the French manufacturer. Following the Court's decision in *Katzel*, Congress enacted § 526 of the Tariff Act of 1922, later reenacted as § 526(a) of the Tariff Act of 1930.⁸ This statute prohibits the importation into the United States of any merchandise:

[1] of foreign manufacture . . . [2] bearing a trademark owned by a citizen of, or by a corporation or association created or organized within . . . the United States, [3] and registered in the Patent and Trademark Office by a person domiciled in the United States . . . [4] unless written consent of the owner of such trademark is produced at the time of making entry.⁹

Thus, a business finding itself in the position of *Bourjois & Co.* is now, at least ostensibly, afforded protection not only by the Supreme Court's decision in *Katzel*, but also by federal statute.

The Customs Service regulations implementing § 526, however, have not extended this protection to all situations. Specifically, there is no § 526 bar to the importation of 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 com-

4. *Id.* at 692.

5. *Id.*

6. *Id.*

7. *Id.*

8. Codified as 19 U.S.C. § 1526 (1982). This statute was characterized as a "hastily drafted provision" and "introduced as a 'midnight amendmen[t]' on the floor of the Senate." *K Mart Corp. V. Cartier*, 486 U.S. 281, 303 (1988).

9. 19 U.S.C. § 1526

mon ownership or control;¹⁰ [or]

(3) The articles of foreign manufacture bear a recorded trademark or trade name applied under authorization of the U.S. owner¹¹

It is these three exceptions to the protection of § 526 that were challenged in *K Mart Corp. v. Cartier Inc.*,¹² with the Supreme Court upholding exceptions (1) and (2) (the “common control” exception) as permissible regulatory interpretations of § 526, but striking down exception (3) (the “authorized use” exception).¹³

II.

An association of United States trademark holders, the Coalition to Preserve the Integrity of American Trademarks,¹⁴ brought suit seeking a mandatory order directing the Customs Service, contrary to its regulations interpreting § 526, to exclude all gray market goods from entry into the United States.¹⁵ The district court judge upheld the regulations.¹⁶ Holding that the “pivotal question” is whether the construction of § 526 by the Customs Service is “sufficiently reasonable” to be accepted by the reviewing court,¹⁷ the court found reasonableness based upon:

[T]he legislative history, judicial decisions, legislative acquiescence, and the long-standing consistent policy of the Customs Service. The regulations clearly implement the limited purpose for which Section 526 was enacted and are consistent with and effectuate the intent of Congress to permit entry of trademarked goods not involving the

10. 19 C.F.R. 133.2(d) (1987) provides definitions for this subsection. “‘Common ownership’ means individual or aggregate ownership of more than 50 percent of the business entity, and . . . ‘[c]ommon control’ means effective control in policy and operations and is not necessarily synonymous with common ownership.”

11. 19 C.F.R. 133.21(c)(1)-(3) (1987).

12. *K Mart*, 486 U.S. 281 (1988).

13. *Id.* at 287.

14. Members of this association are manufacturers or distributors of products such as fragrances and cosmetics, watches, tires, fine crystal, cameras, photographic equipment, binoculars and electronic goods. Coalition to Preserve the Integrity of American Trademarks v. United States, 598 F.Supp 844, 846 (D.C. 1984).

15. *Id.* The Supreme Court defined gray market goods as “a foreign-manufactured good, bearing a valid United States trademark, that is imported without the consent of the U.S. trademark holder.” *K Mart Corp. v. Cartier*, 486 U.S. at 285.

16. *Coalition to Preserve*, 598 F.Supp at 852.

17. *Id.* at 851.

Katzel situation.¹⁸

The court of appeals reversed, holding that the district court “misapprehended the doctrine of deference to an agency interpretation of its governing statute,”¹⁹ and that the Customs Service regulations “cannot be squared with Section 526 and are thus invalid.”²⁰ The court of appeals based its opinion on the Supreme Court’s decision in *Katzel*, which emphasized that trademark law is intended not only to guard against public deception, but also to protect property rights.²¹

Noting this decision, the court of appeals held that Congress “similarly rejected without qualification the *legal theory* underlying the Second Circuit’s opinion in *Katzel* - the view that a trademark genuine in a foreign country is necessarily genuine here as well - and enshrined the alternative ‘territoriality’ approach into law.”²² The Customs Service regulations, therefore, conflicted with Congress’ intent to reject the Second Circuit’s legal theory of trademark protection, and the court struck down the regulations.²³

Furthermore, the court held that even if § 526 were ambiguous, the Customs Service’s interpretation did not display the consistency requisite for judicial acceptance.²⁴ The regulations were not adopted contemporaneously with the statute, were supported only by “poorly articulated and vacillating reasoning,” and were inconsistent.²⁵

The Supreme Court affirmed the court of appeals in part and reversed in part.²⁶ One majority concluded that exceptions (1) and (2)

18. *Id.* at 852.

19. *Coalition to Preserve the Integrity of American Trademarks v. United States*, 790 F.2d 903, 908 (D.C. Cir. 1986).

20. *Id.* at 907.

21. *Id.* at 909-10.

22. *Id.* at 910. (emphasis added).

23. *Id.* at 905. The court continued that if “the intent of Congress is clear, that is the end of the matter . . .” *Id.* at 908 (quoting *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984)).

24. *Id.* at 916.

25. *Id.* at 916-17.

26. *K Mart Corp. v. Cartier*, 486 U.S. 281 (1988). This decision on the merits followed a decision announced in March of 1988 which decided the question of jurisdiction only. *K-Mart Corp. v. Cartier*, 485 U.S. 176 (1988). In that decision the majority held that the district court had jurisdiction under both the federal question provision, 28 U.S.C. § 1331 and the statute permitting jurisdiction over acts of Congress relating to trademarks, 28 U.S.C. § 1338(a). The minority was of the opinion that jurisdiction belonged exclusively to the Court of International Trade for suits over embargoes and other restrictions on the importation of merchandise pursuant to 28 U.S.C. § 1581(i)(3). The merits were not considered in the March decision, most likely, in

created by the Customs Service could stand as a permissible construction of Congress' intent when enacting § 526,²⁷ while a second majority concluded that exception (3) could not be permitted to stand.²⁸

Justice Kennedy began the Court's opinion with an explanation of the typical situations in which gray markets are formed. First, there is the situation presented in *Katzel* involving an American company which purchases from an unaffiliated foreign company the exclusive right to use the foreign company's trademark and sell its trademarked good in the United States (case 1).²⁹ If the foreign company or a third party begins to sell the trademarked good in competition with the holder of the American sales rights, a gray market is formed.

The second situation involves an American company which registers a trademark in the United States for goods that are manufactured by a related company in a foreign country (case 2).³⁰ This situation may involve a foreign manufacturer creating a United States subsidiary which subsequently registers the trademark in order to control United States distribution (case 2a).³¹ Two other possible variations are created when an American company creates a manufacturing subsidiary in another country (case 2b), or its own unincorporated but affiliated manufacturing division in a foreign nation (case 2c).³²

Finally, a third situation which creates a gray market occurs when the owner of an American trademark authorizes a foreign manufacturer to use its trademark (case 3).³³ The foreign manufacturer is independent of the American company and often the authorization contains a condition that the manufacturer may not import the product into the United States. The agreement, however, does not stop third parties from purchasing the product from the foreign manufacturer and subsequently importing it into the United States.

In order to determine whether the Customs Service regulations

order to allow Justice Kennedy the opportunity to break a four to four deadlock created by the vacancy on the Court. In fact, the Court's opinion on the merits consists of two majority opinions written by Justice Kennedy with the concurring opinions of the others. See *infra* notes 27-28 and 125-27 and accompanying text.

27. *K Mart*, 486 U.S. at 284. The majority included Justice Kennedy, with Justices White, Brennan, Marshall and Stevens concurring.

28. *Id.* This majority consisted of Justice Kennedy, with Justices Scalia, Blackmun, O'Connor and Chief Justice Rehnquist concurring.

29. *Id.* at 286.

30. *Id.*

31. *Id.*

32. *Id.* at 286-287.

33. *Id.*

were valid, the Court held that the “reviewing court must first determine if [the Customs Service] regulation is consistent with the language of the statute.”³⁴ “If the statute is silent or ambiguous with respect to the specific issue addressed by the regulation, the question becomes whether the agency regulation is a permissible construction of the statute.”³⁵

A.

The Court held that § 526 was ambiguous when applied to the three variations of case 2. An ambiguity is created in case 2a because the language “bearing a trademark owned by a citizen of, or by a corporation or association created or organized within . . . the United States . . .” does not make it clear which company owns the United States trademark. On one hand it could be argued that the foreign parent, which owns the American subsidiary also owns the trademark, in which case the protections provided in § 526 do not apply. On the other hand it could be argued that it is the American company which owns the trademark regardless of who owns the American company, and therefore the protections of § 526 should apply.³⁶

The Court found a second ambiguity in the phrase “merchandise of foreign manufacture.”³⁷ When applied to the situations involved in cases 2b and 2c, it is possible to interpret “merchandise of foreign manufacture” to mean “goods manufactured in a foreign country”³⁸ in which case protection would be granted. But the phrase can also be read to mean “goods manufactured by a foreign company”³⁹ in which case § 526 would apply only if the foreign subsidiary or unincorporated division were considered to be foreign, even though actually owned by an American company.

The Customs Service regulations contained in subsections (1) and (2) resolve these ambiguities by removing the protection of § 526 whenever the companies involved are under common control. Thus, a foreign parent in case 2a is considered to own the trademark and is not permitted to prohibit the entry of the genuine product. In cases 2b and 2c similar products manufactured by companies abroad are not consid-

34. *Id.* at 291.

35. *Id.* (citing *Chevron U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837, 843 (1984)).

36. *Id.* at 292.

37. *Id.* Only Justice White joined in this particular portion of the opinion.

38. *Id.*

39. *Id.*

ered to be foreign due to the affiliation or actual ownership involved by an American parent.

Justice Brennan, joined by Justices Marshall and Stevens, concurred that § 526 was not intended to extend to subsidiaries of foreign parents, emphasizing the circumstances surrounding the enactment of the statute. "The most blatant hint that Congress did not intend to extend § 526's protection to affiliates of foreign manufactures (case 2) is the provision's protectionist, almost jingoistic flavor. Its structure bespeaks an intent, characteristic of the times, to protect only domestic interests."⁴⁰ A foreign manufacturer cannot invoke § 526 for protection unless it first registers the trademark with the Patent and Trademark Office.⁴¹ But even that is not enough to gain the benefit of § 526 because the trademark must be owned by a citizen or corporation of the United States.⁴²

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 § 526 provides. But they are fragile barriers indeed if a foreign manufacturer might bypass them by the simple device of incorporating a shell domestic subsidiary and transferring to it a single asset - the U.S. trademark.⁴³

Because a reading conferring § 526's protection to a shell subsidiary would make most of the limiting language "pointless,"⁴⁴ Brennan agreed with Justice Kennedy that the Customs Service regulations reasonably avoid this anomaly.⁴⁵ In addition, the concurring Justices held that it is the parent corporation and "not the subsidiary whose every decision it controls [that] better fits the bill as the true owner of any property that the subsidiary nominally possesses."⁴⁶

Brennan also concurred in his opinion that § 526 is ambiguous with regard to the requirement that merchandise be "of foreign manufacture."⁴⁷ This requirement is vague because the phrase could be interpreted to mean either "'merchandise manufactured in a *foreign country*' or 'merchandise manufactured by a *foreigner*.' Under the former definition, the merchandise manufactured abroad [by a domestic firm's subsidiary] would fall into § 526's ban. Under the later defini-

40. *Id.* at 297.

41. 19 U.S.C. § 1526 (1982).

42. *Id.*

43. *K Mart*, 486 U.S. at 298.

44. *Id.*

45. *Id.*

46. *Id.* at 299.

47. *Id.*

tion, however, the coverage is not clear.”⁴⁸ Since the intent of Congress was not to extend protection to foreign affiliates, the Customs Service regulation reasonably resolves the ambiguity.⁴⁹

In his dissent, Justice Scalia, joined by Chief Justice Rehnquist and Justices Blackmun and O’Connor, characterized the majority’s reading of the phrase “of foreign manufacture” as “queer” and “not merely unusual but inconceivable”⁵⁰ Scalia explained his dissatisfaction with the majority’s holding:

The statute excludes only merchandise “of foreign manufacture,” which the majority says might mean “manufactured by a foreigner” rather than “manufactured in a foreign country.” I think not. Words, like syllables acquire meaning not in isolation but within their context. While looking up the separate word “foreign” in a dictionary might produce the reading the majority suggests, that approach would also interpret the phrase “I have a foreign object in my eye” as referring, perhaps, to something from Italy. The phrase “of foreign manufacture” is a common usage, well understood to mean “manufactured abroad.”⁵¹

Thus, the dissent argued that § 526 is clear and unambiguous with its language “of foreign manufacture” and the Customs Service regulations may not be used to alter the intent of Congress.⁵²

Justice Kennedy, writing for a second majority consisting of Chief Justice Rehnquist and Justices White, Blackmun, O’Connor and Scalia, also held that the authorized use exception contained in subsection (c)(3) of the Customs Service regulation did not resolve any similar ambiguity.⁵³ In the case of an unaffiliated company which authorizes the use of its trademark, § 526 clearly allows protection of the trademark from gray market imports. Therefore the regulation operates contrary to the Congressional intent of § 526 and must fall. According to the Court, “[u]nder no reasonable construction of the statutory language can goods made in a foreign country by an independent foreign manufacturer be removed from the purview of the statute.”⁵⁴ In

48. *Id.*

49. *Id.* at 300.

50. *Id.* at 319.

51. *Id.*

52. *See*, Board of Governors, FRS, v. Dimension Financial Corp., 474 U.S. 361, 368 (1986).

53. *K Mart*, 486 U.S. at 293.

54. *Id.* at 294.

his concurrence, Brennan agreed with this result because in case 3 the United States trademark holder “is unambiguously ‘owned by’ a U.S. firm, and registered by a firm ‘domiciled in the United States,’ and the goods sought to be imported are ‘of foreign manufacture.’”⁵⁵

B.

Even before the Court delivered its opinion on the merits, Justice Scalia had identified the importance of the gray market issue. In the decision of the jurisdictional issue,⁵⁶ Justice Scalia characterized the gray market situation as one “which may have immediate and substantial effects on the national economy”⁵⁷ Indeed, in contrasting the jurisdictional question with the question raised on the merits, Justice Scalia noted that the “gray-market question is of greater economic importance.”⁵⁸

The opinions on the merits also reflected the other Justices’ recognition that the issue presented to them was one of importance for business, economics and international trade. Justice Kennedy began the Court’s opinion by describing the reality of how gray markets fit into international commerce.⁵⁹ The other justices either referred to the “multi-billion dollar industry [which] has emerged around [gray market merchandise],”⁶⁰ or expressed concern for how the decision in this case would be received by trade partners abroad.⁶¹

With these very practical economic considerations in mind, the Court proceeded to resolve the questions presented based on the ambiguities of § 526 and the reasonableness of the Customs Service regulations.⁶² Emphasis on the plain meaning of the statute and deference to an agency’s interpretation are the established means of resolving questions of statutory interpretation.⁶³ This method seems particularly unsatisfactory in a case such as *K Mart*, however, when the ultimate decision has such a large impact on business and trade.

Instead of confining itself to a narrow reading of the statutory construction rules, it would have been more appropriate for the Court in

55. *Id.* at 323.

56. *K Mart Corporation v. Cartier, Inc.*, 486 U.S. 176 (1988).

57. *Id.* at 191 (Scalia, J., dissenting).

58. *Id.*

59. *K Mart*, 486 U.S. 281, 286-87 (1988).

60. *Id.* at 295.

61. *Id.* at 322.

62. *Id.* at 292.

63. *See, e.g.*, *Chevron U.S.A., Inc., v. Natuaral Resources Defense Council, Inc.*, 467 U.S. 837, 842-43 (1984).

this case to have considered an analysis of how businessmen involved in the gray market would be affected. The Court could have fairly included economic considerations by broadly construing recent statutory construction precedent. For example, in *Bethesda Hospital Ass'n v. Bowen*,⁶⁴ the Court held that in "ascertaining the plain meaning of the statute, the Court must look to the particular statutory language at issue, as well as the language *and design of the statute as a whole*."⁶⁵ Building on this language, the Court might have considered that the design of § 526 was to create certain protections and build trade barriers.⁶⁶ Because the purpose of the statute was to protect certain businesses, the Court could have appropriately based its opinion, at least in part, on those business practices.

This approach would arguably place the Supreme Court in the role of legislator. The Court is empowered, however, only to interpret what Congress has written, not write the law itself. If Congress, in its farther-reaching power, does not like the practical result of a court's interpretation, it can overrule it by making the language of a statute clearer. Indeed, Congress took this step after the Second Circuit's decision in *Bourjois & Co. v. Katzel*.⁶⁷ A forceful argument for placing Congress in this superior position vis-a-vis the courts is that only Congress, and not judges, have the experience and resources necessary to write the law.

Yet, when an issue of such practical and immediate importance is decided, as in *K Mart*, it would seem impossible for the Supreme Court to reach a decision without considering more than the ambiguity of a statute and legislative history. Instead of parsing statutory language, the Court, in this case, should have reviewed the alternatives to § 526 in the common law as well as extrinsic considerations for businessmen in the gray market such as antitrust and contract law. Reference to such considerations could have lead the Court to a more effective resolution of the problem presented.

III.

The result of the Court's holding in *K Mart* denies the owners of American trademarks who are affiliated with a foreign manufacturer the protection of § 526. Although these commonly controlled entities

64. 485 U.S. 399 (1988)(quoted by the Court in *K-Mart*, 486 U.S. at 291).

65. 485 U.S. at 403-405 (emphasis added).

66. One concurring opinion, in fact, did consider this at length. See *K Mart*, 486 U.S. at 295-96 (Brennan, J., concurring in part and dissenting in part).

67. See *supra* notes 8 and 9 and accompanying text.

may not use the legislation to bar importation, they are not without protection from gray market competition.⁶⁸ In addition, the apparent windfall given to companies which have authorized the use of their marks can be abused: The prohibition on importation created by § 526 may lead to a successful challenge based on contract principles or anti-trust laws.

A.

Alternatives available to the commonly controlled companies for protection from gray market competition fall into two broad areas. First, there are tort remedies such as unfair competition and intentional interference with contractual relations; second, there are state and federal laws which may provide relief.

The tort of unfair competition in its narrowest sense prohibits the "palming off [of] one's goods as those of a rival trader."⁶⁹ This concept, combined with the Supreme Court's notion in *Katzel* that the American seller adds something to an imported good,⁷⁰ could permit an American company to argue that gray market imports are being palmed off as the product of another American company usually associated with the domestic sale of the imported item. Furthermore, unfair competition has been based on acts "which lie outside the ordinary course of business and are tainted by fraud, or coercion, or conduct otherwise prohibited by law."⁷¹ It is relatively easy to characterize one who imports goods on the gray market as engaging in conduct tainted

68. To support its decision to deny the protection of § 526 to affiliated companies, the Court suggested that the holder of a United States trademark could protect itself from gray market competition in one of three ways:

They could, for example, jointly decide in their mutual best interests that the manufacturer (1) should not import directly to any domestic purchaser other than its affiliate; (2) should, if legal, impose a restriction against resale (or against resale in the United States) as a condition on its sales abroad to potential parallel importers; or (3) should curtail sales abroad entirely.

K Mart, 486 U.S. at 302. The first solution suggested will hardly be effective, as the dissent pointed out, because "the bulk of the gray market is attributable to third parties that are unaffiliated with either the manufacturer or the trademark holder." *Id.* at 328. The third solution to curtail sales abroad entirely is not really a solution to the problem of gray market goods, because it simply avoids the creation of a gray market. The second suggestion, as well, may not be viable. Even the Court as it made this suggestion was careful to qualify itself with the crucial phrase "if legal." *See infra* notes 115-24 and text accompanying.

69. *Schechter Corp. v. United States*, 295 U.S. 495, 531 (1935).

70. *See supra* notes 3-7 and text as well as *infra* notes 80-88 and text.

71. *Schechter Corp. v. United States*, 295 U.S. 495, 532 (1935).

by fraud, especially when the consumers are intentionally left ignorant of the true source and circumstances of the importation.

In the case of *William R. Warner & Co. v. Eli Lilly & Co.*,⁷² the Supreme Court found unfair competition in a set of facts very likely to occur in the gray market context. The plaintiff was a manufacturer of a liquid preparation of quinine which was mixed with chocolate in order to create a distinctive color and flavor.⁷³ An affiliate of the defendant began manufacturing a similar product⁷⁴ and Lilly not only sold it at a lower price but "induc[ed] the purchasing druggist in his own interest to substitute, as well as he could, the [cheaper imitation] for the [more expensive original]. In other words, [the defendant] sought to avail itself of the favorable repute which had been established for [the plaintiff's] preparation in order to sell its own."⁷⁵

The Court held that there was no deception, and therefore no unfair competition with regard to the sales to the druggists because the sales involved clearly distinguishing labels.⁷⁶ The sales to the actual consumers, however, usually did involve fraud, and the Court held the defendant liable for the palming off, even though it only sold directly to the druggists.⁷⁷ "That no deception was practiced [by defendant] on the retail dealers, and that they knew exactly what they were getting is of no consequence. The wrong was in designedly enabling the dealers to palm off the preparation as that of the [plaintiff]."⁷⁸ This theory of liability may be of use against an importer of gray goods who sells to a retailer, with the retailer subsequently palming off the goods as originally coming from the United States trademark owner.⁷⁹

72. 265 U.S. 526 (1924).

73. *Id.* at 527-529.

74. The actual manufacturer was the Pfeiffer Chemical Company and the Searle & Hereth Company, both of which were commonly controlled with the defendant Eli Lilly & Company which actually sold the product. *Id.* at 527.

75. *Id.* at 529-30.

76. *Id.*

77. *Id.*

78. *Id.* "One who induces another to commit a fraud and furnished the means of consummating it is equally guilty and liable for the injury." *Id.*

79. Another case that may prove to be a useful analogy to the gray market goods situation is *Hanover Milling Co. v. Metcalf*, 240 U.S. 403 (1916). The Supreme Court's analysis may prove significant because *Hanover Milling Co.* involved a party who misled consumers with similar packaging to an existing trademark, even though the party engaging in the deception was using the trademark lawfully. *Id.* at 424. The Court found unfair competition, notwithstanding the lack of infringing use, based on the defendant's purpose of taking advantage of the plaintiff's advertising and reputation. *Id.* at 423. A less obvious use of the *Hanover Milling Co.* case may be made by the gray market importer. *Hanover Milling Co.* established that common law trade-

Finally, there is an old Eighth Circuit case which found unfair competition in a case directly on point: *Perry v. American Hecolite Denture Corp.*⁸⁰ Plaintiff, the American Hecolite Denture Corporation, received by assignment all United States rights to sell denture blanks manufactured by the German Hecolite company. Defendant purchased denture blanks manufactured by German Hecolite, as did the plaintiff, from retailers in Germany and imported them into the United States. When defendant sold the blanks, he represented only that they were the original denture blanks manufactured by German Hecolite.⁸¹

Analyzing these facts, the court held that "it was incumbent on plaintiff to show that [defendant] had 'palmed off his blanks as those of the plaintiff'; that he was guilty of 'passing off' as it is called in the English law books."⁸² The court found that plaintiff became associated with the name Hecolite in the United States because he sold the denture blanks "in [a] distinctive little green box, [and] vouched for and replaced [the product] whenever complained against . . ."⁸³ Americans had come to expect the plaintiff's product when Hecolite was offered. Despite the fact the products were identical, the court held that the defendant was attempting to sell on the plaintiff's reputation and standing.⁸⁴

Relying on the Supreme Court decision in *Katzel*, as well as English cases "in accord with our own decisions,"⁸⁵ the court considered it settled that "an exclusive sales agent of foreign made trade-marked goods may so carry on his business of selling the goods in the country of import as to there create public understanding that the goods have come from him, though not made by him."⁸⁶ Because a domestic retailer can become known as the source for a foreign manufactured item, the court found an appropriate test for unfair competition to be:

[W]hat, if anything, [is there] to identify the [U.S.] agent with the

mark rights may not create a monopoly in markets or regions to which the mark's trade has never reached. *Id.* at 419. Due to the legitimacy of both marks involved in *Hanover Milling Co.*, and the legitimacy, or at least genuineness, of a gray market trademark, an importer might successfully argue that as long as the United States trademark owner is not selling or advertising in a particular region, the gray market importer is permitted to do so.

80. 78 F.2d 556 (8th Cir. 1935).

81. *Id.* at 561.

82. *Id.* at 559 (citing *Schechter, Warner and Hanover Milling Co.*).

83. *Id.*

84. *Id.*

85. *Id.* at 560.

86. *Id.*

articles dealt in by him which was used to induce the purchaser to buy them; "what, if any, peculiar feature whether in get-up or shape or whatever it may be." Was there anything about the goods which by way of get-up says to the purchaser: "This is a thing for which (the [U.S.] sales agents) are responsible, not necessarily as makers, but as persons who have dealt in it and who guarantee its quality to you."⁸⁷

If there is such a peculiar feature to a good, then an importer has no "right to sell in such a way or under such circumstances as to induce belief or trade upon the understanding that the [goods come] from the [U.S. agent] or they are identical to those sold by the [U.S. agent]."⁸⁸ In the gray market goods context, therefore, a feature peculiar only to the United States trademark and creating public understanding that the goods come from the American trader, would warrant protection.

A second common law cause of action, in addition to unfair competition, is intentional interference with contractual relations. This tort is only loosely, and often mistakenly used by the courts, but it is a viable cause of action.⁸⁹ In addition to the courts which have made actual use of it, the Restatement (Second) Torts has adopted this tort and stated its elements clearly:

One who intentionally and improperly interferes with the performance of contract . . . between another and a third person by inducing or otherwise causing the third person not to perform the contract, is subject to liability to the other for the pecuniary loss resulting to the other from the failure of the third person to perform the contract.⁹⁰

A domestic parent may take advantage of this tort by having its foreign affiliate enter into a contract providing that the affiliate will not sell the trademarked goods in the United States, as well as not sell the goods to a third party who intends to import the goods into the United States. If a third party should purchase the product from the foreign company and subsequently attempt to sell it in the United States, no

87. *Id.* at 560-61.

88. *Id.* at 561.

89. *See e.g.*, *DEP Corp. v. Interstate Cigar Co.*, 622 F.2d. 621 (2nd Cir. 1980).

90. 90. RESTATEMENT (SECOND) TORTS § 766 (1977). *Compare with* RESTATEMENT (SECOND) TORTS § 766C providing that there is no liability for the *negligent* interference with contractual relations.

protection is available from § 526 due to the Customs Service's common control exception, but the Restatement alternative offers a cause of action for relief.⁹¹ The American trademark owner would argue that the gray market importer caused the foreign affiliate to breach its contract regarding resale, and therefore the importer is subject to liability "for the pecuniary loss resulting to the [American company] from the failure of the [foreign firm] to perform the contract."⁹² This argument has found some support in the courts.⁹³

In *DEP Corp. v. Interstate Cigar Co.*,⁹⁴ the plaintiff had been appointed the exclusive United States dealer of soap manufactured under the trademark "Pears."⁹⁵ Defendant purchased the soap from a European middleman and sold it in the United States at a lower price than the plaintiff.⁹⁶ Relying on the Restatement (Second) Torts and New York state common law, the Second Circuit suggested the plaintiff had a cause of action based upon a theory of intentional interference with contract relations.⁹⁷ The suit's basis would have been the defendant's interference with plaintiff's enjoyment of his exclusive distribution contract.⁹⁸

Commonly controlled companies may also be able to protect themselves from gray market competition through various state and federal statutes. For example, the Unfair Import Practices Chapter of the Trade Act of 1974⁹⁹ declares unlawful:

Unfair methods of competition and unfair acts in the importation of articles in the United States, or in their sale by the owner, importer, consignee, or agent of either, the effect or tendency of which is to destroy or substantially injure an industry, efficiently and economically operated, in the United States, or to prevent the establishment of such an industry, or to restrain or monopolize trade and

91. With regard to the knowledge requirement, the RESTATEMENT (SECOND) TORTS § 766 comment i (1977) provides that "to be subject to liability under the rule stated in this Section, the actor must have knowledge of the contract with which he is interfering *and* of the fact that he is interfering with the performance of the contract (emphasis added).

92. RESTATEMENT (SECOND) TORTS § 766 (1977).

93. See *infra* notes 95-99 and accompanying text.

94. 622 F.2d 621 (2nd Cir. 1980).

95. *Id.* at 621.

96. *Id.*

97. *Id.* at 624.

98. *Id.*

99. 19 U.S.C. § 1337 (1982).

commerce in the United States¹⁰⁰

If a violation is found, the Federal Trade Commission is authorized to exclude the articles from entry into the United States.¹⁰¹

There are also two common state laws that could be invoked to provide protection from gray market competition: anti-dilution and unfair competition statutes. A typical anti-dilution statute provides:

Likelihood of injury to business reputation or of dilution of the distinctive quality of a mark or trade name shall be a ground for injunctive relief in cases of infringement of a mark registered or not registered or in cases of unfair competition, notwithstanding the absence of competition between the parties or the absence of confusion as to the source of goods or services.¹⁰²

This statute would allow an American company harmed by gray market goods to argue that the distinctive quality of its mark, perhaps as the only American distributor of a foreign item, has been lost due to the gray market imports. Therefore, an injunction prohibiting the gray goods would be appropriate. Furthermore, if the gray goods are in some way inferior, the domestic trademark owner could argue that an injunction is an appropriate remedy due to the tarnished association consumers have developed due to the deception caused by the gray goods. Even a blurring of the domestic trademark owner's identity as the "official" domestic source of the foreign import would be enough for a cause of action pursuant to most anti-dilution statutes.¹⁰³

State unfair trade practice legislation generally codifies and repeats most of the common law protections mentioned above. For exam-

100. *Id.* § 1337(a).

101. *Id.* § 1337(d), (e) and (f). Similar relief may be granted as well by the Federal Trade Commission pursuant to its power granted by 15 U.S.C. § 45 to prohibit unfair methods of competition and unfair or deceptive acts. 15 U.S.C. § 45 (a)(1) (1988).

Another applicable federal statute is the Lanham Act, 15 U.S.C. § 1051 (1988), which prohibits the use in commerce of any "reproduction, counterfeit, copy, or colorable imitation of a registered mark." 15 U.S.C. § 1114(1) (1988). Due to differences in warranty provisions and servicing arrangements, in addition to the theory announced by the Supreme Court in *Katzel*, this may prove to be a convincing argument. *See supra* notes 3-7 and 80-88 as well as accompanying text.

102. N.Y. General Business Law § 368-d (McKinney 1984).

103. An anti-dilution statute, even if available, will not be easy to use. Courts are unfriendly to these statutes and will only enforce them to a limited extent when the mark is distinctive. *See, e.g.*, J. GILSON, TRADEMARK PROTECTION AND PRACTICE § 5.05[9] (1988).

ple, Maryland's unfair or deceptive trade practices statute prohibits, among other activities, "[f]alse, falsely disparaging, or misleading oral or written statements, visual description, or other representation of any kind which has the capacity, tendency, or effect of deceiving or misleading consumers"¹⁰⁴

B.

If a company wishing to avoid the uncertainties of alternative remedies decides not to affiliate itself too closely with a company abroad and avail itself of the protection of § 526 for authorized use such as in case 3, there still may be legal barriers to surmount. Agreements authorizing a foreign manufacturer to use a trademark will usually contain a provision limiting the sale of the manufactured item to foreign countries and prohibiting its sale in the United States. Such contracts may also limit third parties to whom the authorized manufacturer may sell the goods; namely not to anyone for the purpose of subsequent importation into the United States. These restrictive agreements are an obvious target for a suit alleging antitrust violations.¹⁰⁵ Antitrust violations notwithstanding, however, it is questionable whether courts will uphold contracts containing these types of restrictions.

*Timken Roller Bearing Co. v. United States*¹⁰⁶ involved an action charging antitrust violations against an American company which allegedly combined with its related companies in France and Britain. These three companies signed agreements which provided for, among other things, the allocation of world-wide trade territories among the companies,¹⁰⁷ cooperation to protect each other's markets and eliminate outside competition,¹⁰⁸ and participation in cartels to restrict imports to, and exports from, the United States.¹⁰⁹ Arguing on appeal that the district court erred in its determination that the Sherman Act antitrust laws were violated, Timken contended that the restraints on trade relied on by the lower court were reasonable, and therefore not in viola-

104. MD. COM. LAW CODE ANN. § 13-301(1) (1983).

105. A company wishing to authorize the use of its trademark abroad may, of course, simply not include any restrictions on resale at all. When a gray market import reaches United States Customs, § 526 will deny entry. Relying on the Customs Service and waiting for the infringing goods to enter the country may not, however, provide much peace of mind for the businessman making a substantial investment, and the contract provisions are an obvious place to make certain of protection.

106. 341 U.S. 593 (1951).

107. *Id.* at 596.

108. *Id.*

109. *Id.*

tion of the antitrust laws, because they were "an exercise of Timken's right to license the trademark 'Timken.'" ¹¹⁰

The Supreme Court was not persuaded by this argument. The Court first indicated that the American Timken company was possibly precluded from making this argument because it might not be the owner of the trademark for the British and French corporations.¹¹¹ Assuming American Timken was the owner, however, the Court held that a "trademark cannot be legally used as device for Sherman Act violation."¹¹² The Court found that the agreements "went far beyond protection of the mark 'Timken' and provided for control of the manufacture and sale of [the goods] whether carrying the mark or not."¹¹³ *Timken* therefore provides an indication that agreements authorizing the use of a mark in certain geographical areas only, in order to allocate trade territories, will not be favored by the courts and may violate the Sherman Act.¹¹⁴

If antitrust law does not create a barrier to these agreements, they may be held invalid as a matter of contract law.¹¹⁵ The owner of a trademarked good probably would want to restrict the manufacturer's sale of a good in one of two ways. The most comprehensive method would be a complete ban on the manufacturer from selling to a third party when the third party is a potential gray market importer. A second method would require that the subsequent sale of the good must be at a certain minimum price.¹¹⁶ In this way the trademark holder could

110. *Id.* at 597.

111. *Id.* at 599.

112. *Id.* at 599. The Court supported this proposition by noting that the Trademark Act itself penalizes the use of a mark "to violate the antitrust laws of the United States." *Id.* (citing 60 Stat. 427, 439, § 33(b)(7), 15 U.S.C. §§ 1051, 1115(b)(7) (1988)). ("The reason for the penalty provision was that 'trade-marks have been misused . . . [and] have been used in connection with cartel agreements.' 92 Cong. Rec. 7872." *Timken*, 341 U.S. at 599 n.8).

113. *Id.* at 598-99.

114. See *Timken* at 598. ("[Timken's] premise that the trade restraints are only incidental to the trademark contracts is refuted by the District Court's finding that the 'trade mark provisions [in the agreements] were subsidiary and secondary to the central purpose of allocating trade territories.'" (brackets in original)).

115. The grounds a court would use to strike down such a contract would be broad public policy considerations based on illegal bargaining, judicial hostility to monopolies and analogies to the antitrust laws. As such, the analysis of contract law is related to the antitrust problem above.

116. This involves the sale of an article where the sale contains an agreement fixing the resale price. A trademark owner wishing to limit gray market competition might require the resale price to be the same or a certain percentage higher than the price of the authorized article.

require that the gray market imports be sold at a price high enough to prevent competition with the authorized goods.

The comprehensive ban on all resale to potential gray market importers would not be enforced by the courts. "Under ordinary circumstances, the 'owner' of an article has a complete 'monopoly' in its use and enjoyment."¹¹⁷ The owner has absolute discretion to sell or refuse to sell to a potential gray market importer. But, once the owner has made a sale, his exclusive rights are gone, including his power to refuse to sell to a gray market importer.¹¹⁸ Neither will a notice attached to the article stating that the article may not be imported into the United States be an effective remedy. "If the seller firmly fastens to the article a notice that there shall be no resale . . . for other than a specified use, the notice is wholly inoperative as a control over subsequent owners."¹¹⁹

The second method of using a resale price maintenance agreement¹²⁰ may be a viable alternative. Fair trade laws, enacted in some form by almost every state, and contained in some federal legislation, make these agreements enforceable.¹²¹ The underlying theory of these statutes is that they are only used by producers of an article that is uniform and can be identified by a trademark.¹²² "Its use in no way suppresses the competition of other similar articles with the identified articles, either by other producers [or retailers]. An unreasonable high price will cause consumers to buy competing articles instead and thus decrease the seller's total profits."¹²³ A producer may use these resale agreements to restrain competition because he is only limiting the competition of a good in which he already has exclusive ownership.

The use of uniformity and identification as the key to permitting this type of monopoly suggests that they may not be appropriate in the gray market context. The fact that the gray market exists indicates that there is indeed actual competition between retailers of an identifiable good. A resale price agreement may not be permitted in this context because it would create a monopoly which otherwise would not exist. This is consistent with Corbin's conclusion that these statutes "do not protect persons who use resale price maintenance agreements for the purpose or the effect of obtaining a monopoly that will eliminate

117. A. CORBIN, 6A CORBIN ON CONTRACTS § 1408, at 227 (1962).

118. *Id.*

119. *Id.* at 228.

120. *See supra* note 116.

121. CORBIN at 234.

122. *Id.* at 228.

123. *Id.*

competition with their products.”¹²⁴

IV.

By allowing the exception for commonly controlled or owned companies to stand, one majority of the Supreme Court encourages international competition and free trade across borders. Without the protection of § 526, some companies will not receive a monopoly in the sale of trademarked goods in the United States which could be used to fix higher prices for American consumers. Whatever harm the United States owners of trademarks may claim due to the Court's holding can be mitigated by alternatives to § 526 such as various statutes and tort theories.

The second majority in *K Mart* struck down the authorized use exception to § 526. The effect of this holding is to protect American businessmen from competition in the American companies' own trademarked goods. The same activity of a gray market importer, if done by a domestic firm authorized to use a trademark for manufacturing, would constitute a trademark infringement. The Supreme Court has simply provided analogous protection in the case of a foreign manufacturer authorized to use the trademark. Additionally, this majority prevents a gray market importer from being unjustly enriched by the American trademark holder's advertising expenses, good will, and entrepreneurial skill. Protecting the exclusive rights of an owner of a United States trademark also benefits American consumers by giving them the assurance that the trademarked goods they purchase have a consistent source and quality. This protection, however, if abused, is limited by antitrust and contract law.

The approaches of the two majorities, in terms of trade policy and the effect on international commerce, are inconsistent. The Court's overall holding, however, is consistent with modern statutory construction jurisprudence.¹²⁵ Perhaps the actual disagreement between the two majorities goes not to ambiguities and statutory construction so much as to where the line should be drawn between international free trade on one side, and protection of American business investments on the other.¹²⁶ If this is true, the Court's compromise, even though difficult to

124. *Id.* at 235.

125. *See K Mart Corp. v. Cartier*, 486 U.S. 281, 284 (1988) (Part II A of Justice Kennedy's majority opinion discusses the standard of review for agency regulations and *supra* notes 62-63 and text).

126. This conclusion is supported by the fact that Justice Kennedy's terse opinion for the majorities, focusing only on the language and intent of the statute and regula-

reconcile with regard to trade policy, at least does not create an undue burden on international businessmen.

tions was joined only by Justice White, and then only for one section. *Id.* The other justices and the Chief Justice all wrote or joined concurring opinions indicating that their interest was in much more than simple statutory construction.

