GRAY MARKET GOODS: AN OVERVIEW OF U.S TRADEMARK LAW TO PREVENT THE UNLAWFUL IMPORTATION OF GRAY MARKET GOODS: by Andrew Holland

"Gray market" is the term used to describe the sale of new, used, surplus and refurbished products through unauthorized resellers or channels. Gray market goods, also commonly referred to as "parallel imports" are goods or merchandise, otherwise legitimate and genuine, but which, upon importation to the United States, may be considered to be unlawful when they are sold in competition with authorized U.S. distributors.

Gray market goods include any number of different products that are legally manufactured and given intellectual property protection, purchased outside the United States by someone other than an authorized importer or distributor, and then imported for sale in the United States at a typically much lower price. Because U.S. manufacturers are at a severe disadvantage when competing with gray marketers who offer essentially the same goods at lower prices, they try to prevent the re-importation of these goods.

Legal Issues

According to authorized dealers, the price differential causes unfair competition and trademark infringement. They argue that the unauthorized flow of gray market goods into the United States jeopardizes high product quality standards, diminishes customer satisfaction and dilutes brand integrity.

Of course, gray marketers argue that parallel importing is a legitimate business and the price differential is fair because they are not offering the same services offered by the authorized dealers. Reputable gray marketers make it clear to the consumer that the product is not covered by the factory warranty and they may even offer their own warranties.

An Overview of U.S. Legal Authority Regarding Gray Market Goods

In contrast to claims brought under patent and copyright laws where owners may exclude all others from selling or distributing items covered by the rights, U.S.trademark laws merely allows the trademark holder to prevent others from confusing one's customers in the marketplace.

A trademark protects brand names, slogans and other symbols used by businesses to differentiate their products from those of competitors. In order to determine when trademark owners will be protected against the use of a mark, on a product which has not been approved by the trademark holder, courts must determine the likelihood that "an appreciable number of ordinarily prudent purchasers are likely to be misled or confused as to the source of the goods." *See Mushroom Makers, Inc. v. R.G. Barry Corp.*, 580 F.2d 44, 47 (2d Cir. 1978).

The right of importation of trademarked goods in the United States is protected under the Lanham Act and under the Tariff Act. Section 526 of the Tariff Act prohibits the importation of trademarked goods without the explicit written consent of the owner. Section 526 is the only means by which a U.S. company can use its trademark to prevent importation of gray market goods into the United States.

Section 42 of the Lanham Act, 15 U.S.C.A. §1142, establishes authority for U.S. Customs Service to prevent entry of gray market goods into the United States. Generally, Section 42 of the Lanham Act provides protection against deception or confusion concerning an article's origin or sponsorship by restricting the importation of trademarked goods under certain circumstances. Obviously, it is a very difficult endeavor to prevent the unlawful importation of gray market goods into the United States because of the extreme measures that gray marketers may take to unlawfully import the goods compounded by the limited resources of U.S. Customs.

Section 42 if of the Lanham Act applies to goods that are physically and materially different from the domestic product, and thus are likely to cause consumer confusion. If a good is not physically or materially different from the domestic product, the Lanham Act will not prevent its importation. It is important, therefore, to consider the question of what constitutes a genuine good, which as a result would be exempt from claims of Lanham Act violations.

In *John Paul Mitchell Systems v. Pete-N-Larry's Inc.*, 862 F. Supp. 1020 (W.D.N.Y. 1994), the court recognized that "[c]ourts have most often discussed the question of genuineness in conjunction with that of customer confusion, and given the fact that the genuineness concept is a derivation of the consumer-confusion concept…the test for genuineness may yet prove to be identical to a mere component of the that for the likelihood of consumer confusion rationale." The court in *Yamaha Corp. of America v. U.S.*, 961 F.2d 245 (D.C. Cir. 1992) defined genuine goods as follows:

"Genuine goods are goods that are in fact manufactured by the same manufacturer that supplies the U.S. trademark holder. In other words, they are to be distinguished from goods that "copy or simulate" the genuine article; they are the genuine article, although they may not have been intended for distribution in the U.S. market."

One case that is particularly illustrative is *Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc.,* 982 F.2d 633 (1st Cir. 1992). In an action brought by a competitor for trademark infringement and unfair competition based upon Section 42, the District Court for the District of Puerto Rico found that an importer was a distributor of "genuine goods," and allowed continued importation. This led to an appeal. The plaintiff, SDP Nestle, owned the trademark for lines of PERUGINA chocolates manufactured primarily in Italy. SDP Nestle granted an exclusive distributorship to its subsidiary, Nestle Puerto Rico, to distribute its Italian made chocolates in Puerto Rico. SDP Nestle also granted a license to Alimentos for the distribution of Venezuelan made PERUGINA chocolates in Venezuela. The defendant in this case, Casa Helvetia, bought the Venezuelan brand of PEREGINA chocolates from Alimentos and distributed them in Puerto Rico.

SDP Nestle alleged that Casa Helvetia infringed its trademark and engaged in unfair competition by importing a materially different product under its trademark in violation of the Lanham Act. In particular, SDP Nestle alleged that Helvetia violated Sections 42 and 43 of the Lanham Act by importing and selling the Venezuelan version of the chocolate candies in Puerto Rico. SDO Nestle argued that the commerce would create consumer confusion and dilute Nestle's goodwill.

The court found that the Venezuelan chocolates were clearly marked as being made in Venezuela and were packed similarly in terms of logos, pictures and symbols. But the chocolates were packaged dissimilarly in terms of language used, price and presentation. Also the chocolates themselves were different; the Italian version was produced in more shapes. The court found that the differences of quality, composition, packaging, and price were all relevant to the determination that the two versions of the chocolates were not genuine. In light of the differences in standards of quality control measures, the court granted protection to the domestic product.

Similarly, in *Martin's Herend Imports, Inc. v. Diamond & Gem Trading USA, Co. 112* F.3d 1296 (5th Cir. 1997), the court considered whether parties to an exclusive distributorship agreement could enjoin the importation and sale of similar products by another importer. The court held that "territorial protection is applicable under the Lanham Act where two merchants sell physically different products in the same market and under the same name, for it is this prototype that impinges on a trademark holder's goodwill and threatens to deceive consumers." Ultimately, the court held that the Lanham Act prohibits importation and sale of goods that, while genuine, are materially different from those imported by an exclusive distributor.

Martin's was the exclusive importer and distributor of expensive porcelain tableware and figurines produced by a Hungarian corporation, Herend. Martin's and Herend carefully selected which Herend pieces were offered for sale in the United States, and they chose not to import many of the items.

Juhasz, the owner and operator of Diamond & Gem Trading USA, began selling Herend items that were originally purchased in the United States and at the Herend company store in Hungary. Juhasz also offered for sale Herend items that were acquired through private collections. Some of these Herend pieces were not available for sale in the United States by Martin's. These items constituted gray market goods.

Herend and Martin's sued Juhasz for trademark infringement and sought a permanent injunction barring Juhasz from selling Herend products. Martin's sought judgment on the theory that "the pieces sold by Juhasz, even if genuine, were materially different from those imported by Martin's for sale in this country under its rights as the exclusive importer and distributor of Herend wares. The difference is between those lines of Herend products Martin's imports and those lines it does not import."

The appellate court agreed and affirmed the injunction, but it also limited the scope of the injunction based on the "first sale rule".[1] The court reasoned that the Lanham Act provides "trademark protection to an owner's efforts to maintain the value and goodwill of the trademark in a particular territory, where the owner has endeavored to confine the use of the trademark to certain goods." Absent such restriction, "the importation of goods properly trademarked abroad but not intended for sale locally may confuse consumers and may well threaten the local mark owner's goodwill." The likelihood of confusion is presumed as a matter of law when the products are materially different.

The court articulated the test for trademark infringement in this situation by stating that "infringement will result if the goods sold by the authorized domestic distributor and the defendant's foreign goods are materially different... at least when the goods in question are highly artistic, luxury goods." In this case, the Herend products sold by Juhasz were different from those sold by Martin's. Juhasz sold figurines of guinea hens and rabbits that Martin's did not sell. In addition, some of Juhasz's Herend items had painted patterns and colors different from those offered by Martin's. "As a matter of law, such differences are material, since consumer choices for such artistic pieces are necessarily subjective or even fanciful, depending on each consumer's personal artistic tastes."

As it has been shown with relation to Section 42 of the Lanham Act, trademark infringement cases generally do not protect against the sale of a genuine good that properly bears a trademark, even if such sale is without the owner's consent. *Shell Oil Co. v. Commercial Petroleum, Inc.* 928 F.2d 104 (4th Cir. 1991); NEC *Electronics v. CAL Circuit Abco*, 810 F.2d

[1] In trademark law, the "first sale" rule generally does not reach the sale of genuine goods bearing a true mark even though such sale is without the owner's consent. (Also See *Shell Oil Co. v. Commercial Petroleum, Inc.*, 928 F.2d 104 (4th Cir. 1991) Once a trademark owner sells their product, the buyer ordinarily may resell the product under the original mark without incurring any trademark law liability.

1506 (9th Cir. 1987). This is true because if the import is substantially similar to the domestic product, and it bears a legitimate trademark, consumers will not be disappointed by the quality of the goods or deceived as to the source of the goods. However, if there is a substantial difference between two products, especially if it is subtle enough to go unnoticed by consumers, likelihood of confusion will arise.

This point was reaffirmed in *Davidoff & CIE, S.A. v. PLD Intern Corp.*, 263 F.3d 1297 (11th Cir. 2001). In *Davidoff*, the court considered for the first time the circumstances under which the resale of a genuine product with a registered trademark can be considered infringement, and agreed with the general rule that a trademark owner's authorized initial sale of its product eliminates the trademark owner's right to maintain control over who thereafter sales the product, unless the product is materially different.

Conclusion

There seems to be a general trend by the courts in deciding that identical goods sold in an unauthorized manner are not genuine for purposes of the Lanham Act. For instance, in *Caterpillar, Inc. v. Nationwide Equipment*, 877 F. Supp. 611 (M.D. Fla. 1994), the court placed particular emphasis on plaintiff's inability to perform quality control over an unauthorized distributor's sale of its products when determining the goods were not "genuine". In *Caterpillar*, defendants sold, without authorization, products manufactured using plaintiff's components and identified them by using plaintiff's trademarks. Defendants obtained certificates of origin from plaintiff for the component parts of the machinery and thereafter used those certificates to falsely represent that the machines were plaintiffs. Material differences between defendant's equipment and plaintiff's included the quality control methods and the composition. The court determined that variance in quality control created a presumption of customer confusion as a matter of law. In this case, it is clear that the defendants' deceptive business practices resulted in the court's unfavorable decision.

The key for gray marketers to avoid liability is to minimize the likelihood of creating customer confusion over whether the goods sold are backed by authorized dealers' good will and warranties. It should be made clear to purchasers that gray marketers are not simply offering the same goods offered by authorized dealers for lower prices, and it should be clear that the product is not covered by any applicable warranties. Gray marketers should also avoid procuring goods and redistributing them in territories that are already covered by exclusive distribution agreements because this is strong evidence that it was never intended that the goods be resold in these territories. Under these circumstances, gray marketers may face related tort claims for knowingly interfering with or circumventing existing distribution agreements.

To the extent that gray marketers engage in deceptive or nefarious conduct in order to procure otherwise genuine goods at lower prices, courts will likely interpret the Lanham Act more liberally to impose liability.