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Statutory and Judicial Approaches to Gray Market Goods: The "Material Differences" Standard

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Gray market transactions can assume a myriad of different forms.\textsuperscript{2} In the most basic sense, gray market goods (also called "parallel imports")\textsuperscript{3} are genuine goods that are sold through unauthorized channels in direct competition with authorized distributors.\textsuperscript{4} Most commonly, the goods are manufactured abroad, imported into the United States, and sold under the mark of a U.S. mark holder. See \textit{K Mart Corp. v. Cartier, Inc.}, 486 U.S. 281, 285 (1988) ("A gray-market good is a foreign-manufactured good, bearing a valid United States trademark, that is imported without the consent of the United States trademark holder."). \textit{K Mart Corp.} is discussed \textit{infra} notes 69--73 and accompanying text.

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\textsuperscript{2} As the U.S. Supreme Court has noted, gray markets can arise in a variety of contexts. The common feature in all, however, is that the allegedly infringing goods are manufactured abroad, imported into the United States, and sold under the mark of a U.S. mark holder. See \textit{K Mart Corp. v. Cartier, Inc.}, 486 U.S. 281, 285 (1988) ("A gray-market good is a foreign-manufactured good, bearing a valid United States trademark, that is imported without the consent of the United States trademark holder."). \textit{K Mart Corp.} is discussed \textit{infra} notes 69--73 and accompanying text.

\textsuperscript{3} The Third Circuit characterized the semantic difference between the two terms as follows:

The term "gray-market goods" refers to foreign manufactured goods, for which a valid United States trademark has been registered, that are legally purchased abroad and imported into the United States without the consent of the American trademark holder.

Appellants in the present case note that the term "gray-market" unfairly implies a nefarious undertaking by the importer, and that the more accurate term for the goods at issue is "parallel import." We agree that the term parallel import accurately describes the goods and is, perhaps, a better term because it is devoid of prejudicial suggestion. For that reason, we use that term in this discussion. However, we also employ the term "gray-market" good because, for better or worse, it has become the commonly accepted and employed reference to the goods at issue.


\textsuperscript{4} According to the Federal Circuit, gray market goods are:

Goods [which] are produced and legitimately sold abroad under a particular trademark and are imported into the United States and sold in competition with goods of the owner of U.S. trademark rights in the identical mark. But for international boundaries and the territoriality of trademark rights, the use of the trademark in competition with the U.S. owner would not constitute infringement because of the relationship between the foreign entity from whom the goods were directly or indirectly obtained and the owner of U.S. rights in the mark. In this sense,
produced or sold abroad under the authority or license of a U.S. mark holder, and under a mark that is used both abroad and in the United States. The goods are then imported into the United States without authorization from the U.S. mark holder and in violation of lawful arrangements made by the mark holder to prohibit such importation and sales.

"Gray market" goods differ from "black market" goods in that gray market goods are not illegal and can be legitimately sold abroad. They are not "counterfeit" goods because they have been manufactured and the mark has been affixed to them (often by a foreign subsidiary or licensee) under the authority of the U.S. owner of the mark. It is only their distribution in the United States, not their existence or sale abroad, that makes gray market goods potentially illegal.

Gray markets typically arise because of differentials between the prices at which goods are sold overseas and the prices at which they are sold in the

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gray market goods are "genuine" and bear a "genuine" trademark. Vivitar Corp. v. United States, 761 F.2d 1552, 1555 (Fed. Cir. 1985); see also Gamut Trading Co. v. United States Int’l Trade Comm’n, 200 F.3d 775, 777 (Fed. Cir. 1999) ("The principle of gray market law is that the importation of a product that was produced by the owner of the United States trademark or with its consent, but not authorized for sale in the United States, may, in appropriate cases, infringe the United States trademark.").

5 As described by the Restatement (Third) of Unfair Competition:

Gray market goods are goods produced abroad under a trademark that properly identifies the source of goods in the country of origin, but which are subsequently marketed in this country without the consent of the owner of the trademark in the United States. A gray market can result from various marketing arrangements. A domestic company may purchase exclusive United States distribution and trademark rights from a foreign manufacturer, for example, or a foreign manufacturer may form a domestic subsidiary to which it grants the exclusive right to market goods under the trademark in this country. Similarly, a domestic trademark owner may retain exclusive rights in the United States but license the use of the mark to a foreign company for sales abroad. In these and other situations, a gray market develops when a third person purchases foreign-made goods bearing the trademark and imports them into the United States for sale in competition with the United States trademark owner.


7 Yamaha Corp. of Am. v. United States, 961 F.2d 245, 248 (D.C. Cir. 1992) ("Gray-market goods are distinguished from counterfeit goods in that the use of the United States trademark is authorized by the holder of the foreign trademark.").
U.S. manufacturers often sell goods, particularly consumer goods, in foreign markets at substantially lower prices. These lower prices may reflect the fact that a foreign distributor, rather than the U.S. manufacturer, is incurring the foreign marketing and advertising costs; may reflect differences in product characteristics or in availability of warranties or customer service; or may be the result of a deliberate strategy on the part of the U.S. manufacturer to expand its foreign sales. Price differentials can also occur as the result of currency fluctuations or taxation differences. The price differential is often large enough that a distributor can then re-import the goods to the United States at a price that undercuts the domestic market.

Gray markets pose a number of competing policy concerns. Gray marketers argue that their activities are legal because the goods they sell are genuine and bear lawful marks. Thus, they contend that consumers are not confused as to the source or origin of these goods. Consumer advocates also argue in favor of gray markets, asserting that gray markets allow consumers to purchase goods at a lower cost, thereby preventing price gouging by manufacturers and promoting consumer welfare.

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8 See Lawrence M. Friedman, Business and Legal Strategies for Combating Grey-Market Imports, 32 INT'L LAW. 27, 28 (1998); Shubha Ghosh, An Economic Analysis of the Common Control Exception to Gray Market Exclusion, 15 U. PA. J. INT'L BUS. L. 373, 373 (1994) ("[W]hen goods bearing identical trademarks are sold at different prices in two different geographic regions," incentives arise "for an arbitrageur to buy goods in the market with the lower price and resell those goods in other markets at higher prices.").


10 See Auvil, supra note 9, at 438.

11 There are many possible explanations why a grey market importer can sell cheaper than the exclusive distributor. Although arbitrary price discrimination is one possible explanation, there are many others... including particularly fluctuations in international currency markets, differing cost conditions in other countries, and the fact... that the plaintiff-markholder incurs many costs that the grey marketer does not. These include, at a minimum, all the costs incurred for the maintenance and enhancement of the mark's reputation, such as advertising and public relations, consumer and dealer education, warranty service, and maintenance of inventory.

Osawa & Co., 589 F. Supp. at 1176; see also Auvil, supra note 9, at 438.


Manufacturers' groups, on the other hand, argue that gray markets harm their goodwill and brand image. They complain that gray marketers are able to reap the benefits of the manufacturers' expensive manufacturing and advertising campaigns without incurring any of the accompanying costs. Companies that hold exclusive rights to distribute and sell products in the United States are also upset about facing unanticipated competition from importers and sellers of gray market goods. In addition, if the gray market goods differ materially from the goods produced for the domestic market in quality, product characteristics, labeling, or other key elements, U.S. consumers may be disappointed by the gray market goods, and the value of the mark to the U.S. mark holder may be considerably diminished.

The issue of gray markets has become a pressing concern to manufacturers over the past decade, as changing world markets and economic conditions have caused gray market activities to expand rapidly. Current estimates on the size of gray markets are difficult to find and are industry-specific, but they generally suggest a problem of staggering proportions. In 2003, for example, industry analysts estimated the global gray market for information technology products alone to be $40 billion in sales, resulting in an estimated $5 billion in lost profits annually.

No specific federal statutory provision addresses the problem of gray market goods. Rather, plaintiffs have been forced to shoe-horn their gray market complaints into existing provisions of either the Tariff Act of 1930 or the traditional trademark infringement provisions of the Lanham Act. Because these statutory provisions were not written with the gray market issue in mind, the courts have had to step in and create a substantial body of jurisprudence to support and clarify these causes of action. Much of this case law has arisen since the late 1980s, when gray market activities became prevalent. Over the past two decades, the initially messy and somewhat chaotic case law has evolved into a coherent pattern. Though hampered by an inapposite and inadequate legislative scheme, the courts have done an admirable job of creating a mechanism for addressing gray market goods.

14 See Osawa & Co., 589 F. Supp. at 1168 (noting that the plaintiff, a U.S. mark owner, suffered harm as a result of gray market sellers free-riding on the plaintiff's advertising expenditures and public relations efforts); see generally Auvil, supra note 9, at 438–39.

15 Osawa & Co., 589 F. Supp. at 1168 (gray market competition caused "demoralization, disaffection, and misunderstanding among authorized dealers," who mistakenly believed the U.S. mark owner was favoring the gray market sellers).


18 See infra notes 54–111 and accompanying text (describing the statutory bases for gray market causes of action).
that is consistent with the traditional twin trademark law goals of preventing consumer confusion and protecting mark holders' goodwill, without straying too far beyond the confines of the existing legislative scheme.

This Article focuses primarily on gray market causes of action that arise under the traditional trademark infringement provisions of the Lanham Act. Part I provides a brief description of the evolution of gray market jurisprudence throughout the twentieth century. Part II describes the statutory bases for gray market causes of action, which arise under Section 526 of the Tariff Act of 1930 and under Sections 32, 42, or 43 of the Lanham Act. Gray market causes of action, depending upon the statutory provision being used, may result in traditional trademark infringement remedies or a barring of importation of the gray market goods. Part III analyzes the "material differences" standard that the courts have developed for evaluating gray market claims under the Lanham Act. Part IV contains concluding remarks.

I. The Foundations of Gray Market Jurisprudence

The law regarding gray markets evolved considerably during the twentieth century. Other scholars have provided in-depth analyses of the historical foundations of gray market jurisprudence, so I provide only a brief overview here. In general, courts tend to apply one of two competing theories to gray market cases: (1) the older universality principle, under which a mark is viewed as having no territorial limits and ownership is exhausted once the mark is sold; and (2) the more modern territoriality principle, under which a mark is viewed as being exclusively owned by the registrant or user within each sovereign territory. The territoriality principle clearly dominates contemporary gray market jurisprudence (as well as contemporary trademark law in general), and it has important ramifications for the resolution of gray market disputes.

Prior to 1923, the universality principle prevailed. As described by a later court, under the universality principle, "goods lawfully made under a trademark in one country, could be imported and sold in another country, without infringing the rights of the domestic trademark owner." The net


20 See Lansing & Gabriella, supra note 13, at 317-18; see also Restatement (Third) of Unfair Competition § 24 cmt. f (1995).

21 See Am. Circuit Breaker Corp. v. Or. Breakers, Inc., 406 F.3d 577, 581 (9th Cir. 2005) ("It is now generally agreed and understood that trademark protection encompasses the notion of territoriality.").

22 For a general history of the universality principle, see Hiebert, supra note 19, at 21-42.

23 Philip Morris, Inc. v. Allen Distrib., Inc., 48 F. Supp. 2d 844, 850 (S.D. Ind. 1999) (cit-
effect of the universality principle was to deny protection to U.S. trademark holders from gray market goods. For example, in the first gray market case decided by a U.S. court, *Apollinaris Co. v. Scherer*, the plaintiff was the exclusive U.S. distributor of mineral water sold under the mark HUNYADI JANOS. The owner of the mark marketed the water in Europe. Although the mark owner's bottles carried a statement cautioning against importation into the United States, the defendant purchased the mark owner's bottled water and imported it into the United States. When the defendant sold the bottled water in competition with the exclusive U.S. distributor of the water, the distributor sued, alleging trademark infringement.

The court rejected the claim, stating flatly that because "the defendant is selling the genuine water... the trade-mark is not infringed." The court also applied the exhaustion principle, finding that the trademark owner's right to control the branded goods ceased once the goods entered the stream of commerce. More importantly, however, the *Apollinaris* court relied upon the universality principle in rejecting the trademark owner's claim. The court opined that world trademark rights are indivisible and that territorial trademark licenses (such as those purportedly granted to the U.S. distributor by the mark owner) could not be created. The *Apollinaris* court stated: "It was not possible by any contract... [for the mark owner] to


26 *Id.*

27 *Id.* at 20.

28 See infra notes 132-36 and accompanying text (discussing the first sale doctrine and exhaustion of rights).

29 *Apollinaris*, 27 F. at 21.
create a territorial title to the products of the spring; no such title is known to the law of personal property.”

In effect, under the universality principle, trademarks were considered solely an indication of the source of the good and did not establish goodwill or other intangible benefits for the mark holder. Courts adhering to the universality principle maintained that if a trademark was lawfully affixed to goods in one country, those goods could be lawfully imported to another country, even if another party in that second country held the exclusive right to the mark. The original manufacturer was considered to be the source of the good identified by the trademark; thus, no confusion could arise when genuine goods bearing the mark were imported into the United States. As a consequence, a U.S. mark holder who had a contract for the exclusive right to import foreign-marked goods had no remedy against a third party who purchased genuine-marked goods abroad and imported them into the United States.

Moreover, under the universality principle, a U.S. manufacturer could not bar third parties from re-importing goods bearing its mark and intended for sale in foreign markets. Rather, the courts maintained that the first authorized sale of a validly trademarked product anywhere in the world exhausted the trademark holder's exclusionary rights, i.e., once the mark holder had released branded goods into the stream of commerce, the mark holder lost the right to control the future distribution of those goods. Under this principle, the U.S. mark holder had no right to bar the importation and sale of authentically-marked foreign goods.

30 Id.
31 Lansing & Gabriella, supra note 13, at 317; see also K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 301 (1988) (Under the universality approach, "trademarks do not confer on the owner property interests or monopoly power over intrabrand competition. Rather, they merely protect the public from deception by indicating 'the origin of the goods they mark.'") (citing A. Bourjois & Co. v. Katzel, 275 F. 539, 543 (2d Cir. 1921), rev'd, 260 U.S. 689 (1923)).
32 See RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 24 cmt. f (1995) ("Several early decisions adopted a 'universality' principle of trademark rights under which goods lawfully made under a trademark in one country could be imported and sold in another country without infringing the rights of the domestic trademark owner."); 2 Gilson, supra note 23, § 5.10A ("A gray market product does not violate trademark rights under the universality principle as long as it bears a genuine trademark that identifies the source of the product.").
34 See generally 4 MCCARTHY, supra note 24, § 29:51 ("Early U.S. cases refused to protect U.S. trademark owners from parallel imports of genuine goods obtained from the foreign manufacturer.").
36 See Gamut Trading Co. v. U.S. Int'l Trade Comm'n, 200 F.3d 775, 778 (Fed. Cir. 1999)
The universality principle reflected the infant stage of development that the law of trademarks was in during the late 1800s. For example, the Apollinaris court saw no role for trademarks "except to vouch for the genuineness of the thing which it distinguishes from all counterfeits . . . ."37 Today, by contrast, trademarks are widely recognized as not only identifying the source of goods but also as identifying and differentiating products, indicating consistent quality, facilitating advertising and sales, and representing business goodwill.38

As the law began to recognize the expanded functions that trademarks serve, the universality principle began to wither,39 ultimately giving way to the territoriality principle.40 In A. Bourjois & Co. v. Katzel,41 decided by the United States Supreme Court in 1923, the Court rejected the universality principle, adopting instead the territoriality principle, under which a mark is recognized as having a separate legal existence in each sovereign country in which it is registered or otherwise legally recognized as a mark and receives the legal protection afforded by that country.42

In Katzel, the defendant purchased genuine JAVA cosmetic powder in France, imported it into the United States, and sold it under the JAVA mark without the permission of the plaintiff, who purchased the U.S. business and the U.S. trademark for JAVA.43 The Second Circuit followed precedent

39 See Osawa & Co. v. B & H Photo, 589 F. Supp. 1163, 1171 (S.D.N.Y. 1984) ("Since [Katzel], the universality principle has faded and been generally supplanted by the principle of 'territoriality' . . ."); id. at 1173 (discussing how "[t]he universality principle . . . was flawed in several related respects"); RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 24 cmt. f (1995) (universality principle has been rejected under U.S. law).
42 See 2 Gilson, supra note 23, § 5.10A.
based on universality principles and held there was no trademark infringe-
ment.\textsuperscript{44}

The Supreme Court reversed.\textsuperscript{45} Justice Holmes, writing for a unani-
mous Court, stated that the true significance of the trademark is to signify
the local business goodwill of the U.S. owner of the mark, not to signify
the origin or manufacture of the goods.\textsuperscript{46} The Court also established that
trademarks are inherently limited in territorial scope:

Ownership of the goods does not carry the right . . . to sell them at all in
a given place. . . . 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. It was sold and could only be sold with the
good will of the business that the plaintiff bought. It stakes the reputation
of the plaintiff upon the character of the goods.\textsuperscript{47}

Thus, under the territoriality principle, the trademark is viewed as not
necessarily identifying to consumers in a particular country the original
manufacturer of the goods, but rather as identifying the company that owns
the exclusive trademark rights within that country. As explained by one
court, the territoriality principle:

\begin{quote}
[R]ecognizes that a trademark has a separate legal existence under each
country's laws, and that its proper lawful function is not necessarily to spe-
cify the origin or manufacture of a good (although it may incidentally do that),
but rather to symbolize the domestic goodwill of the domestic markholder
so that the consuming public may rely with an expectation of consistency
on the domestic reputation earned for the mark by its owner, and the owner
of the mark may be confident that his goodwill and reputation (the value of
the mark) will not be injured through use of the mark by others in domestic
commerce.\textsuperscript{48}
\end{quote}

Although the territoriality principle dominates modern U.S. trademark
law,\textsuperscript{49} \textit{Katzel} and its articulation of the territoriality principle have not been

\textsuperscript{44} \textit{A. Bourjois & Co.}, 275 F. at 540 ("The question is whether the defendant has not the
right to sell this article under the trade-marks which truly indicate its origin. We think she
has.").

\textsuperscript{45} \textit{Katzel}, 260 U.S. 689 (1923).

\textsuperscript{46} \textit{Id.} at 692. While \textit{Katzel} was on appeal to the U.S. Supreme Court, Congress enact-
ed section 526 of the Tariff Act of 1922, with the apparent intent of overruling the Second
Circuit's decision. See infra note 63 and accompanying text. The \textit{Katzel} Court did not reference
this new legislation in its decision.

\textsuperscript{47} \textit{Katzel}, 260 U.S. at 692 (citation omitted).


\textsuperscript{49} The territoriality approach is also adopted by the Paris Convention for the Protection
universally embraced. Some courts sought to limit *Katzel* to its facts,⁵⁰ and the territoriality principle itself has been characterized by one leading treatise "as obsolete in a world market where information products like computer programs cannot be located at a particular spot on the globe."⁵¹

Although the issue of gray markets received little judicial attention in the decades following *Katzel*,⁵² changing international market conditions in the 1980s magnified the prominence of the issue and resulted in an increased number of gray market cases.⁵³ As the plaintiffs in these cases quickly discovered, however, Congress had not enacted a statutory provision specifically addressing gray market claims. Trademark owners upset by the gray market sales of their products were (and still are) forced to shoe-horn their claims into the statutory provisions of either the Tariff Act of 1930 or the Lanham Act. As discussed below, both statutes provide, at best, an uneasy fit for such claims.

II. STATUTORY BASES FOR GRAY MARKET CAUSES OF ACTION

Plaintiffs may base their gray market complaints on either Section 526 of the Tariff Act of 1930⁵⁴ or various sections of the Trademark Act of 1946, commonly known as the Lanham Act.⁵⁵ Most plaintiffs employ multiple

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⁵⁰ *See*, e.g., Well Ceramics & Glass, Inc. v. Dash, 878 F.2d 659, 669 (3d Cir. 1989) ("We do not read *Katzel* to extend beyond [its] circumstance."); Olympus Corp. v. United States, 792 F.2d 315, 321-22 (2d Cir. 1986) (restricting the reach of *Katzel* because "the Supreme Court [has] suggested that *Katzel* [has] limited application to any but its own special facts"); *see also* RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 24 cmt. f (1995) ("The scope and meaning of the territoriality principle announced in Katzel remain unclear. The broadest interpretation recognizes independent trademark rights in the domestic owner by operation of law, and any importation and sale of gray market goods without the domestic owner's consent would thus be an infringement. This view gives primacy to the domestic law of registration and ownership without regard to the actual significance of the trademark in the marketplace. Some cases, limiting the Katzel decision more closely to its facts, have held instead that when the domestic trademark owner and the foreign manufacturer are affiliated, gray market sales do not infringe.").

⁵¹ ⁴ *McCarthy*, supra note 24, § 29:1.

⁵² *See* Bell & Howell: Mamiya Co. v. Masel Supply Co., 548 F. Supp. 1063, 1065 (E.D.N.Y. 1982) ("legal journals [were] the main battleground" for gray market issues post-*Katzel*), vacated, 719 F.2d 42 (2d Cir. 1983).

⁵³ *See* 4 *McCarthy*, supra note 24, § 29:46 ("[C]hanging world economic conditions led to a torrent of court decisions concerning parallel imports in the late 1980s.").


gray market activities do not fit neatly within either statutory regime, courts were forced to fill in the interstices of the law in this area with substantial case law, which led to the creation and evolution of the material differences test.

A. Barring Importation of Gray Market Goods: Section 526 of the Tariff Act and Section 42 of the Lanham Act

A U.S. trademark owner who is alert and able to identify potential gray market goods before they enter the country may solicit the assistance of the U.S. Customs Service in barring the importation of the goods under Section 526 of the Tariff Act and/or Section 42 of the Lanham Act. While the material differences standard arises in Section 42 cases, it does not apply to Section 526 cases. Nonetheless, because Section 526 and Section 42 are dilution statutes; R.J. Reynolds Tobacco Co. v. Premium Tobacco Stores, Inc., 58 U.S.P.Q.2d (BNA) 1532, 1533 (N.D. Ill. Mar. 21, 2001) (arising under federal dilution statute), aff'd sub nom. R.J. Reynolds Tobacco Co. v. Cigarettes Cheaper!, 462 F.3d 690 (7th Cir. 2006); Grupo Gamesa S.A. v. Dulceria El Molino Inc., 39 U.S.P.Q.2d (BNA) 1531, 1534 (C.D. Cal. Apr. 9, 1996) (arising under Lanham Act and California dilution statute).

In addition, Section 337 of the Tariff Act, 19 U.S.C. § 1337, also prohibits importation of articles that infringe a registered trademark and protects against infringement of unregistered marks. The International Trade Commission (ITC) may file suit for a Section 337 violation, and can issue exclusion orders against the importation of gray-market goods and cease-and-desist orders barring the sale of already-imported gray market goods. See generally Margo A. Bagley, Comment, Using Section 337 of the Tariff Act of 1930 to Block Materially Different Gray Market Goods in the Common Control Context: Are Reports of Its Death Greatly Exaggerated?, 44 EMORY L.J. 1541, 1558 (1995); Bryan A. Schwartz, Remedy and Bonding Law Under Section 337: A Primer for the Patent Litigator, 81 J. PAT. & TRADEMARK OFF. SOC'Y 623, 623 (1999). Section 337 is used primarily in patent infringement cases, see id. at 1554, but has been used in some gray market cases as well. See, e.g., Bourdeau Bros., Inc. v. Int'l Trade Comm'n, 444 F.3d 1317, 1320 (Fed. Cir. 2006); SKF USA Inc. v. Int'l Trade Comm'n, 423 F.3d 1307, 1309 (Fed. Cir. 2005), cert. denied, 126 S. Ct. 2968 (2006); Gamut Trading Co. v. United States Int'l Trade Comm'n, 200 F.3d 775, 776-77 (Fed. Cir. 1999). Section 337 proceedings can be in rem against the product itself—an advantage if the identity of all infringers is not known at the time of the proceeding, 19 U.S.C. § 1337(d) (2000). The ITC can issue temporary or permanent exclusion orders that bar importation of goods, 19 U.S.C. § 1337(d)-(e) (2000). The material differences test can apply in Section 337 cases. See generally Vivek Koppiyar, Evaluating the International Trade Commission's Section 337 Investigation, 86 J. PAT. & TRADEMARK OFF. SOC'Y 432 (2004).

56 See infra notes 58–88 and accompanying text.
57 See infra notes 89–111 and accompanying text.
59 See infra notes 75–88 and accompanying text.
often used in tandem, Section 526 is a crucial part of the mosaic of statutory provisions governing gray market cases and so is discussed briefly here.

A mark owner may simultaneously pursue Section 526 benefits and Lanham Act remedies. While Section 526 of the Tariff Act requires the U.S. mark holder to be a U.S. domiciliary, Section 42 of the Lanham Act does not. Normally, a plaintiff who owns a U.S. registration and who is domiciled in the United States will seek relief under both Section 526 and Section 42.

1. Section 526 of the Tariff Act.—Section 526 of the Tariff Act of 1930 prohibits importation of goods bearing a registered mark owned by a U.S. citizen or corporation without the consent of that trademark owner. Under U.S. Customs Service regulations, prohibited marks include those that are actual identical counterfeits of the original mark as well as those so similar that the public is likely to associate the copied or simulated mark with the original.

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60 Section 526(a) provides, in relevant part:

Except as provided in subsection (d) of this section, it shall be unlawful to import into the United States any merchandise of foreign manufacture if such merchandise, or the label, sign, print, package, wrapper, or receptacle, bears a trademark owned by a citizen of, or by a corporation or association created or organized within, the United States, and registered in the Patent and Trademark Office by a person domiciled in the United States, ... and if a copy of the certificate of registration of such trademark is filed with the Secretary of the Treasury, ... unless written consent of the owner of such trademark is produced at the time of making entry.

19 U.S.C. § 1526(a) (2000). Section 526 was initially enacted as section 526 of the Tariff Act of 1922, and subsequently reenacted as section 526 of the Tariff Act of 1930. See also Coty, Inc. v. Le Blume Imp. Co., 292 F. 264, 269 (S.D.N.Y.) (“Had the Supreme Court reversed [Katzel earlier], it would not have been enacted at all.”), aff’d, 293 F. 344 (2d Cir. 1923); Lipner, supra note 19, at 99–128 (providing history of Section 526). An excellent summary of the legislative and regulatory history of Section 526 is found in Vivitar Corp. v. United States, 593 F. Supp. 420, 425–28 (Ct. Int’l Trade 1984), aff’d, 761 Ed 1552 (Fed. Cir. 1985). See also Osawa & Co. v. B & H Photo, 589 F. Supp. 1163, 1171–72 (S.D.N.Y. 1984) (discussing history of Section 526); Hiebert, supra note 19, at 66–84 (discussing history of Section 526).

61 Proof of likelihood of confusion is not required under Section 526. To invoke the aid of the Customs Service in excluding the importation of gray market goods, the trademark owner must record its mark with Customs. See 19 C.F.R. § 133.1 (2005) (describing trademarks eligible to be recorded with Customs).

62 19 C.F.R. § 133.21(a) (2005). The Customs Service must evaluate the mark from the perspective of an “average purchaser,” not an “expert.” See Montres Rolex, S.A. v. Snyder, 718 F.2d 524, 531–32 (2d Cir. 1983) (adopting the “average purchaser” test and explaining that Customs should compare the challenged mark to that actually used by the registrant, not to the exact form of the mark shown on the registration record, because “[t]o allow such differences to undercut the protection Congress intended to grant the trademark owner would be absurd”).
Section 526 was originally enacted by Congress in 1922, at least partly in response to its rejection of the Second Circuit's holding in A. Bourjois & Co. v. Katzel that if the allegedly infringing goods were the same as the genuine goods sold under a true mark, the trademark owner's rights were not infringed. As discussed earlier, the Supreme Court subsequently reversed the Second Circuit's decision in Katzel, making no mention of the newly-enacted Section 526, but instead emphasizing the territoriality of trademark rights.

In the first fifty years following the enactment of Section 526, the Customs Service adopted a series of implementing regulations with varying interpretations of the underlying statute. In 1972, Customs again amended


The Second Circuit decision in Katzel had greater significance at the time than may be readily apparent. During World War I, the Alien Property Custodian (an arm of the federal government) had seized assets in this country owned by foreign nationals of enemy countries and had sold them to U.S. interests. Thus, a number of substantial U.S. businesses had been created, e.g., the U.S. maker of Bayer aspirin, which was entirely independent of its German counterpart and which would have been adversely affected by importation of "genuine" goods from abroad with the normalization of international relations. Thus, the Katzel litigation was pursued to the U.S. Supreme Court, which accepted the case, and efforts were also directed to Congress to provide relief from the Second Circuit's decision.

Vivitar, 761 F.2d at 1562. According to the legislative history:

A recent decision of the circuit court of appeals [Katzel] holds that existing law does not prevent the importation of merchandise bearing the same trade-mark as merchandise of the United States, if the imported merchandise is genuine and if there is no fraud upon the public. The Senate amendment makes such importation unlawful without the consent of the owner of the American trade-mark.

Id. (quoting H.R. Rep. No. 67-1223, at 158 (1922)).

64 See supra note 45 and accompanying text.

65 See Katzel, 260 U.S. 689 (1923) (discussed supra notes 41-47 and accompanying text).

66 Initially, the Customs Service adopted regulations that simply recognized that U.S. owners of registered marks are entitled to the protection of Section 526. By 1936, however, Customs had enacted regulations that prohibited imports of foreign goods bearing genuine marks unless the U.S. mark owner consented; the prohibition did not apply where the same entity owned both the foreign and domestic marks. Vivitar Corp. v. United States, 593 F. Supp. 420, 429 (Ct. Int'l Trade 1984), aff'd, 761 F.2d 1552 (Fed. Cir. 1985). A 1953 revision of the regulations allowed importation of such goods even in the absence of the mark owner's consent if the foreign mark was owned by a company related to the U.S. mark owner. Vivitar, 761 F.2d at 1552, 1556. In 1959, Customs returned to the 1936 exception. See id. at 1567 (noting, for example, that "importation was allowed without consent only if the 'same entity' owned
its regulations, this time to permit importation under Section 526 where: (1) the foreign and domestic marks were owned by the same person or entity; (2) the foreign producer and the domestic mark owner were under common control (such as in a parent-subsidiary relationship); or (3) the domestic mark owner had authorized the use of the mark, though not the importation of the goods. The first two exceptions were known, respectively, as the "common ownership" and "common control" exceptions; the third was known as the "authorized use" exception.

These three exceptions to the regulations were highly controversial, and a number of U.S. trademark owners challenged the legality of Customs' regulations. The end result was inconsistent decisions by various circuit courts of appeals. In 1988, the U.S. Supreme Court resolved the conflict regarding the legality of Customs' regulations in K Mart Corp. v. Cartier, Inc. The suit was brought by an association of U.S. mark holders who rights here and abroad ").

67 See K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 289 n.2 (1988) (quoting 19 C.F.R. § 133.21(c) (1987), which the case partially invalidated). K Mart is further discussed infra notes 69-73 and accompanying text. See also Vivitar, 761 F.2d at 1561–68 (setting forth history of Customs regulations on Section 526).

68 See Vivitar, 761 F.2d at 1570 (holding that the regulations were "valid but not controlling with respect to the scope of protection" afforded to a U.S. trademark owner and that a U.S. owner may file suit to enjoin the sale of parallel imports as a violation of Section 526 even where the regulations would not bar importation); Olympus Corp. v. United States, 792 F.2d 315, 320 (2d Cir. 1986) (upholding the regulation and noting that mark owners have the right under Section 526(c) to pursue private remedies against importers even if Customs declines to exclude the goods). Compare Coal. to Pres. the Integrity of Am. Trademarks v. United States, 790 F.2d 903, 918 (D.C. Cir. 1986) (holding that the regulations were inconsistent with legislative intent and the statute, and that a U.S. trademark owner may bar importation of products bearing an identical mark regardless of the U.S. company's relationship to the foreign manufacturer), aff'd sub nom. K Mart Corp. v. Cartier, Inc., 485 U.S. 176, and aff'd in part, rev'd in part, 486 U.S. 281 (1988), with Premier Dental Prods. Co. v. Darby Dental Supply Co., 794 F.2d 850, 858–60 (3d Cir. 1986) (trademarks have a territorial foundation and gray market goods that infringe on the domestic goodwill of the U.S. trademark owner may be enjoined).

69 Cartier, Inc., 486 U.S. 281.

The Court outlined three basic gray market scenarios in an effort to describe the gray market problem:

Case 1: A domestic firm purchases the rights to register and use an independent foreign firm's trademark as a U.S. trademark and to sell its foreign-manufactured goods in the United States. If the foreign manufacturer or a third party imports the goods into the United States, they would be gray market goods competing with the domestic firm's goods. See id. at 286 (defining this as the "prototypical" gray market case, based on Katznel).

Case 2: The domestic firm registers the U.S. trademark "for goods that are manufactured abroad by an affiliated manufacturer." In variation 2(a), a foreign firm incorporates a U.S. subsidiary, which then registers a U.S. trademark identical to the parent's foreign trademark in its own
sought an injunction against the enforcement of Customs’ regulations on the grounds that they were not a reasonable administrative interpretation of Section 526.70

A sharply divided Court held, in a plurality opinion, that the common-ownership and common-control exceptions of Customs’ regulations were reasonable administrative interpretations of Section 526,71 but the authorized-use exception was not.72 The net result is that Section 526 of the Tariff Act bars importation of foreign-made goods where the U.S. trademark owner is a U.S. entity and is unaffiliated with the foreign manufacturer of the goods; no showing of a likelihood of customer confusion is necessary.73 The prohibitions of Section 526 do not apply, however, when both the foreign and domestic owners are subject to common control.74

2. Section 42 of the Lanham Act.—Section 42 of the Lanham Act also bars the importation of gray market goods, although it addresses goods having

name. Variation 2(b) occurs when an American-based firm establishes a manufacturing subsidiary corporation abroad; variation 2(c) occurs when an American-based firm establishes its own unincorporated manufacturing division abroad. In both instances, the foreign facility is used to produce U.S. trademarked goods for importation for domestic distribution. If the trademarked goods are sold abroad, the parallel importation of these goods creates a gray market. See id. at 286–87.

Case 3: The domestic holder of a U.S. trademark “authorizes an independent foreign manufacturer to use” the mark; if the goods are imported into the U.S. market without the domestic trademark’s holder's authorization, a gray market exists. Id. at 287.

The K Mart Court addressed only the validity of Customs’ regulations with respect to Section 526 of the Tariff Act; the Court did not interpret the Tariff Act itself, nor did it address the scope of private causes of action under Section 526 or trademark owners’ remedies under the Lanham Act. Id. at 290 n.3.

70 Id. at 290.

71 Id. at 294. Thus, the Court held that 19 C.F.R. § 133.21(c)(1) and (2) were valid.

72 Id. at 294. The authorized-use exception was found at 19 C.F.R. § 133.21(c)(3); see supra note 67.


74 See United States v. Eighty-Three Rolex Watches, 992 F.2d 508, 512–14 (5th Cir. 1993) (parallel importation not prohibited where domestic and foreign owners of the mark are subject to common ownership and control).
a mark that "copies or simulates" a registered mark. Unlike Section 526 of the Tariff Act, Section 42 of the Lanham Act protects foreign, as well as domestic, entities owning U.S. registered marks.

Section 42 only prevents the importation of "non-genuine" goods. This qualification is important because goods are generally regarded by the courts as non-genuine if they are "materially different" from the trademark owner's goods authorized for sale in the United States. This issue was addressed in 1993 in Lever Brothers Co. v. United States. Both Lever Brothers Co., a U.S. company, and its British affiliate, Lever Brothers Limited, manufactured SHIELD deodorant soap and SUNLIGHT dishwashing liquid. The products were formulated differently to satisfy the consumer preferences and circumstances of the two different local markets, and the products were packaged differently.

Lever Brothers Co. argued that the importation of the British goods by a third party violated Section 42 of the Lanham Act. The Customs Service, however, allowed importation of the goods under the "affiliate exception" to its regulations, which permitted importation of foreign goods bearing U.S. trademarks when "[t]he foreign and domestic trademark or tradename owners are parent and subsidiary companies or are otherwise subject to common ownership or control." Customs argued that Section 42 applied only to imports of goods bearing marks that "copy or simulate" registered marks, not to "genuine" marks, and asserted that a mark applied by a for-

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75 15 U.S.C. § 1124 (2000). This section provides in relevant part: "[N]o article of imported merchandise ... which shall copy or simulate a trademark registered in accordance with the provisions of this chapter ... shall be admitted to entry at any customhouse of the United States ... ."

76 See, e.g., Weil Ceramics & Glass, Inc. v. Dash, 878 F.2d 659, 672 (3d Cir. 1989) (Section 42 has "two broad policy goals ...: (1) protection against consumer deception ... [and] (2) protection of the trademark holder's investment in goodwill ... [N]either of the goals is undermined by the importation of genuine goods."); Olympus Corp. v. United States, 792 F.2d 315, 321 (2d Cir. 1986) ("The plain language of the statute does not bar importation if the goods are genuine, only if they 'copy or simulate' a trademark."). The D.C. Circuit distinguished these cases on the grounds that the goods at issue were genuine because they were not physically or materially different from the authorized goods. Lever Bros. Co. v. United States, 877 F.2d 101, 109 (D.C. Cir. 1989) [hereinafter Lever Bros. 1989]; see also IPB, Inc. v. Hady Enters., Inc., 267 F. Supp. 2d 1148, 1165 n.29 (N.D. Fla. 2002) ("Generally, trademark law ... does not apply to the resale of genuine, trademarked goods by someone other than the trademark owner.").

77 See, e.g., Lever Bros. Co. v. United States, 981 F.2d 1330, 1338 (D.C. Cir. 1993) ("Trademarks applied to physically different foreign goods are not genuine from the viewpoint of the American consumer.") [hereinafter Lever Bros. 1993]; Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F.2d 633, 639 (1st Cir. 1992) ("[T]he importation of a gray good identical to a good authorized for sale in the domestic market does not violate section 42." However, "the existence of physical differences changes the result.") (citations omitted).

78 Lever Bros. 1993, 981 F.2d at 1333.
79 Id. at 1331.
80 Id. at 1331–32 (quoting 19 C.F.R. § 133.21(c)(2) (1987)) (brackets in original).
eign firm subject to common ownership or control with the domestic trade-
mark owner is, by definition, "genuine." The District Court rejected Lever Brothers Co.'s motion for an injunction, and the company appealed. The D.C. Circuit tentatively held, pending further consideration on remand, that where the authorized U.S. goods are physically and materially different from the foreign goods, Section 42 of the Lanham Act prohibits importation of goods bearing a mark that copies or simulates a U.S. mark, regardless of whether the mark is genuine or whether there is an affiliation between the two firms involved. After remand, the D.C. Circuit reiterated that an affiliation of the type present did not reduce the probability of consumer confusion and that to the American consumer, marks applied to physically different foreign goods are not "genuine." Thus, the Lever Bros. court held that Section 42 does not permit application of Customs' "affiliate exception" where the U.S.-authorized and foreign goods are physically and materially different.

In response to the Lever decision, the Customs Service amended its regulations in 1999 to create a caveat to its "affiliate exception" to the prohibition of gray market imports. The caveat to the affiliate exception, which is known as "the Lever Rule," bars the importation of goods bearing a genuine trademark or trade name where the goods are physically and materially different from the goods authorized by the U.S. trademark owner for importation or sale in the United States, unless the goods bear a "conspicuous and legible label" noting the existence of the physical material differences. The Lever Rule continues to control in this area today.

81 Id. at 1337–38.
83 Lever Bros. 1989, 877 F.2d at 111 ("[T]he natural, virtually inevitable reading of § 42 is that it bars foreign goods bearing a trademark identical to a valid US trademark but physically different, regardless of the trademarks' genuine character abroad or affiliation between the producing firms.").
84 Lever Bros. 1993, 981 F.2d at 1338 ("The fact of affiliation between the producers in no way reduces the probability of [consumer] confusion . . . .") (quoting Lever Bros. 1989, 877 F.2d at 111).
85 See supra quotation of Lever Bros. at note 77. While Lever Bros. was analyzed under Section 42 of the Lanham Act, its analysis of consumer confusion applies as well to infringement claims brought under Sections 32 or 43(a). See, e.g., Ferrero U.S.A., Inc. v. Ozak Trading, Inc., 753 F. Supp. 1240, 1246 n.10 (D.N.J.), (noting that although Lever Bros. was decided under Section 42, its "reasoning and logic employed are germane" to cases arising under Section 43 as well: "The analysis employed in assessing the impact of such action is no less valid and illuminating, merely because a differing statutory provision is in question.")., aff'd, 935 F.2d 1281 (3d Cir.), and rev'd, 952 F.2d 44 (3d Cir. 1991) (reversing only the award of attorney fees).
86 Lever Bros. 1993, 981 F.2d at 1338.
88 19 C.F.R. § 133.23(b) (2005). The label must state: "This product is not a product
B. Suing for Trademark Infringement: Sections 32 and 43 of the Lanham Act

The Lanham Act governs the federal registration and use of marks and provides causes of action for infringement of such marks. Marks are the words or symbols used by companies or individuals to distinguish or identify their goods or services. They serve the important functions of identifying and differentiating products or services, indicating consistent source and quality, and facilitating advertising and sales. As discussed earlier, trademarks are "territorial"; i.e., they extend only to the boundaries of the sovereign that registers or recognizes the mark. Moreover, because manufacturers often tailor products to different markets, a trademark's reputation and goodwill may well vary from nation to nation.

Two general principles underlie the Lanham Act. First, the Act seeks to protect consumers from confusion. In the words of the Supreme Court, trademark protection is intended to ensure that the consuming public "will get the product which it asks for and wants to get." Second, the Act seeks to protect the mark owner's goodwill and the owner's "ability to shape the contours of his reputation."

The traditional cause of action under the Lanham Act is for infringement. Infringement typically occurs when the defendant uses a mark that is identical or substantially similar to the existing mark of the plaintiff on competing goods, such that prospective purchasers are likely to be confused, mistaken, or deceived as to the identity or source of the goods involved. The hallmark of a trademark infringement claim, therefore, is the
existence of customer confusion. This same standard applies to gray market actions brought under Sections 32 and 43: do U.S. consumers identify the foreign manufacturer as the source of the allegedly gray market goods (in which case there is no infringement), or do they identify the U.S. trademark owner as the source (in which case there is infringement)? In determining whether consumer confusion is likely, courts look to the standard of an average hypothetical consumer—one who, in the eyes of many courts, is not regarded as overly discerning. In the words of the Second Circuit, "[t]he law is not made for the protection of experts, but for the public—that vast multitude which includes the ignorant, the unthinking and the credulous, who, in making purchases, do not stop to analyze, but are governed by appearances and general impressions." Thus, the consumer confusion test sets a fairly low bar for infringement plaintiffs.

In addition to protecting consumers from deceit and confusion, trademark law protects the goodwill of the trademark holder. This protection

1077 (2d Cir. 1993)); Hormel Foods Corp. v. Jim Henson Prods. Inc., 73 F.3d 497, 502 (2d Cir. 1996) (question is whether the defendant's use of the mark and image creates a "likelihood that an appreciable number of ordinarily prudent purchasers are likely to be misled, or indeed simply confused, as to the source of the goods in question") (quoting Mushroom Makers, Inc. v. R.C. Barry Corp., 580 F.2d 44, 47 (2d Cir. 1978)).

96 For a discussion of the factors that courts use to evaluate whether likelihood of consumer confusion exists, see AMF Inc. v. Sleekcraft Boats, 599 F.2d 341, 348-54 (9th Cir. 1979). See generally 2 GILSON, supra note 23, § 5.01.

97 See Philip Morris, Inc. v. Allen Distribs., Inc., 48 F. Supp. 2d 844, 852 (S.D. Ind. 1999) ("The key inquiry under sections 32(1)(a) or 43(a) of the Lanham Act is whether Defendants' activities are likely to cause consumer confusion."). As stated in the Restatement (Third) of Unfair Competition:

The "source" indicated by a trademark may instead be the company perceived by consumers as assuring the consistent quality of the goods. In gray market contexts, a factual question thus exists as to whether the trademark identifies the domestic trademark owner or the foreign manufacturer. To the extent that the trademark identifies to prospective purchasers the domestic owner as distinguished from the foreign manufacturer, imported gray market goods are not goods the source of which is accurately identified by the trademark . . . . The sale of such goods under the trademark is therefore an infringement.


99 The Supreme Court stated that:

The protection of trade-marks is the law's recognition of the psychological function of symbols . . . A trade-mark is a merchandising short-cut which induces a purchaser to select what he wants, or what he has been led to believe he wants. The owner of a mark exploits this human propensity by making every effort to impregnate the atmosphere of the market with the drawing power of a congenial symbol. Whatever
extends beyond the sale of inferior goods by another party. As the First Circuit stated: "[e]ven if an infringer creates a product that rivals or exceeds the quality of the registrant's product, the wrongful sale of the unauthorized product may still deprive the registrant of his ability to shape the contours of his reputation."100 The Lanham Act thus protects a mark holder from the sale of goods that are different from those legitimately sold under the mark, even if those other goods are of the same or even higher quality.101

Two sections of the Lanham Act offer relief to plaintiffs seeking to sue for trademark infringement as a result of gray market activities: Section 32 and Section 43. Both of these sections have been interpreted as applying to gray market situations.102 A similar analysis typically applies under both sections,103 requiring a finding that "the defendant's goods are likely to be thought to have originated with, or to have been sponsored by, the true owner of the mark."104

1. Section 32 of the Lanham Act.—Section 32 is available to both domestic and foreign entities who own U.S. registered marks. It provides the owner of a U.S. registered trademark with a cause of action against anyone who, without the owner's consent, uses a "reproduction, counterfeit, copy, or colorable imitation of a registered mark" in such a way as to create a likelihood of confusion, mistake, or deception.105 To be successful, a claim brought

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101 See Truck Equip. Serv. Co. v. Fruehauf Corp., 536 F.2d 1210, 1216 (8th Cir. 1976) (Lanham Act violation existed even though plaintiff's and defendant's goods were of "equal quality").


103 See Nestle, 982 F.2d at 640 ("Whether the fulcrum of plaintiffs' complaint is perceived as section 32(1)(a), section 42, or section 43(a), liability necessarily turns on the existence vel non of material differences between the products of a sort likely to create consumer confusion."); Ferrero U.S.A., Inc. v. Ozark Trading, Inc., 753 F. Supp. 1240, 1246 n.10 (D.N.J.) ("[T]he reasoning and logic employed [in a § 42 claim] are germane to a § 43 violation.").


105 Section 32(1)(a) provides in pertinent part:

(1) Any person who shall, without the consent of the registrant—

(a) use in commerce any reproduction, counterfeit, copy, or colorable imit-
under Section 32 requires "a showing of the likelihood of consumer confusion as to source of origin." 106

Gray market goods by definition bear authentic trademarks (it is only their distribution that is arguably illegal). Moreover, genuine goods do not lead to customer confusion, and accordingly, their sale is not barred by trademark law. 107 To obtain a remedy under Section 32, therefore, the aggrieved trademark owner must show that the gray market products involved are not "genuine." As discussed below, this generally requires a finding of "'material differences' between the products sold by the trademark owner and those sold by the alleged infringer." 108

2. Section 43 of the Lanham Act.—Section 43(a) of the Lanham Act prohibits the marketing of goods bearing a "false designation of origin," a false de-

15 U.S.C. § 1114(1)(a) (2000). This cause of action is not limited to gray market goods but can also be used to challenge the sale of domestic goods in circumstances materially different from those specified by the trademark owner. See, e.g., Warner-Lambert Co. v. Northside Dev. Corp., 86 F.3d 3 (2d Cir. 1996) (trademark owner entitled to injunction against sale of trademarked cough drops past their expiration date); Matrix Essentials, Inc. v. Emporium Drug Mart, Inc., 988 F.2d 587 (5th Cir. 1993) (finding no material difference where the identical domestic products were sold through authorized and unauthorized channels); Shell Oil Co. v. Commercial Petroleum, Inc., 928 F.2d 104 (4th Cir. 1991) (finding material difference and enjoining wholesaler where it sold trademarked Shell oil but did not conform to stringent quality control standards imposed by Shell on its licensees); see also Iberia Foods Corp. v. Romeo, 150 F.3d 298, 302 (3d Cir. 1998) (Infringement by materially different goods "is not limited to gray goods cases . . . . The same theory has been used to enjoin the sale of domestic products in conditions materially different from those offered by the trademark owner."). The Fifth Circuit noted that domestic material differences cases raise different issues than parallel import cases because the territorial scope of the trademark is not at issue in a domestic case: "[T]rademark protection can extend 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." Martin's Herend Imps., Inc. v. Diamond & Gem Trading USA, Co., 112 F.3d 1296, 1302 (5th Cir. 1997).


107 See NEC Elecs. v. CAL Circuit Abco, 810 F.2d 1506, 1509 (9th Cir. 1987) ("Trademark law generally does not reach the sale of genuine goods bearing a true mark even though such sale is without the mark owner's consent . . . . The reason is that trademark law is designed to prevent sellers from confusing or deceiving consumers about the origin or make of a product, which confusion ordinarily does not exist when a genuine article bearing a true mark is sold.") (citations omitted)); Novartis Animal Health US, Inc. v. LM Connelly & Sons, Pty. Ltd., No. 04 Civ. 10213 (BSJ) (RLE), 2005 U.S. Dist. LEXIS 15214, at *9 (S.D.N.Y. July 20, 2005); NEC Electronics, 810 F.2d at 1509 (trademark law does not generally prohibit the sale of genuine goods because such goods do not lead to customer confusion).

108 Iberia Foods, 150 F.3d at 302-03.
scription, or a false representation.109 "Origin" here refers not only to geographic origin but also to "origin of source, sponsorship, or affiliation."110 Unlike Section 32, Section 43(a) applies to both registered and unregistered marks. The "key question" in determining gray market liability under Section 43(a) is nonetheless similar to that employed under Section 32: "[W]hether material differences likely to confuse consumers exist between [authorized and unauthorized goods] bearing the same mark."111

III. The "Material Differences" Standard

The existing statutory scheme was not drafted with the thought of gray market causes of action in mind, and it has taken some effort for gray mar-

109 Section 43(a) provides in pertinent part:

(1) 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 representation of fact, which—

(A) 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 . . .

shall be liable in a civil action by any person who believes that he or she is or is likely to be damaged by such act.


110 4 McCarthy, supra note 24, § 27:14.


In addition, under Section 43(b), Customs may prohibit importation of goods that violate Section 43(a). See 19 C.F.R. § 11.13(a) (2005) ("Articles which bear, or the containers which bear, false designations of origin, or false descriptions or representations, including words or other symbols tending falsely to describe or represent the articles, are prohibited importation under 15 U.S.C. §§ 294–96, 1124, 1125 or 48 U.S.C. § 1405q, and shall be detained."); see also United States v. Nippon Miniature Bearing Corp., 155 F. Supp. 2d 707, 708 (Ct. Int'l Trade 2001) ("Customs may deny entry to merchandise that violates Section 43(a).") Customs need not obtain a judicial ruling before undertaking such an action but rather may make its own determination that such a violation has occurred. Id. at 708. Section 43(b) provides:

Any goods marked or labeled in contravention of the provisions of this section shall not be imported into the United States or admitted to entry at any customhouse of the United States. The owner, importer, or consignee of the goods refused entry at any customhouse under this section may have any recourse by protest or appeal that is given under the customs revenue laws or may have the remedy given by this chapter in cases involving goods refused entry or seized.

ket complainants to fit their claims into this framework. The traditional Lanham Act consumer-confusion test is difficult to apply in gray market cases because gray market goods are generally considered to be genuine.\textsuperscript{112} The courts have responded to their efforts by creating the material differences standard. This standard has now evolved into the predominant test for evaluating gray market claims under the Lanham Act, regardless of whether those claims arise under Section 32, 42, or 43.\textsuperscript{113}

Under traditional trademark infringement law, when the same mark is used on two blatantly different products, such as use of the mark MAYFLOWER for a moving company and for a sailboat company,\textsuperscript{114} no Lanham Act violation has occurred because customer confusion is unlikely, as is diminishment of the goodwill of either product.\textsuperscript{115} However, the probability of customer confusion increases dramatically when identical or nearly identical marks are displayed on goods that are substantially similar in function or appearance.

In translating this rule to the gray market scenario, courts have held that if there is even one "material" difference (defined as a difference that consumers would likely consider in making their purchasing decision) between the imported goods and the goods produced for the domestic market, consumer confusion is likely, the U.S. trademark holder's goodwill is diminished, and the importation and sale of the gray market goods infringes the U.S. mark.\textsuperscript{116} Because manufacturers often alter products to satisfy specific preferences in different national markets, such material differences are likely to exist in many, though not all, instances involving gray market goods.\textsuperscript{117} The material differences standard acts as a proxy for the likeli-


\textsuperscript{113} See Nestle, 982 F.2d at 640. To a large extent, the material differences test incorporates the notions of territoriality found generally in modern trademark law. As the First Circuit explained, "[T]erritorial protection kicks in 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." Id. at 637 (citation omitted).


\textsuperscript{115} Nestle, 982 F.2d at 641 ("[U]sing the same mark on two blatantly different products normally does not offend the Lanham Act, for such use is unlikely to cause confusion and is, therefore, unlikely to imperil the goodwill of either product.").

\textsuperscript{116} Id. at 641 ("[T]he existence of any difference . . . that consumers would likely consider to be relevant when purchasing a product creates a presumption of consumer confusion sufficient to support a Lanham Act claim.").

\textsuperscript{117} See Grupo Gasesa S.A. v. Dulceria El Molino, Inc., 39 U.S.P.Q.2d (BNA) 1531, 1533 (C.D. Cal. Apr. 9, 1996) (material difference occurred where the unauthorized goods did not contain the same ingredient (enriched flour) or provide the required information regarding ingredients, nutritional content, and country of origin); Helene Curtis, Inc. v. Nat'l Wholesale Liquidators, Inc., 890 F. Supp. 152, 159 (E.D.N.Y. 1995) (unauthorized goods were materially different where they did not meet New York or California requirements regarding ingredi-
hood of confusion test traditionally used in trademark infringement cases, permitting gray market goods to be sold unless the goods are "materially different" from those sold through authorized distribution channels.

A. The Underpinnings of the Material Differences Test: Customer Confusion and the First Sale Doctrine

The material differences standard was first explicitly articulated in a 1987 decision by the Second Circuit, *Original Appalachian Artworks, Inc. v. Granada Electronics, Inc.* The plaintiff owned the U.S. mark CABBAGE PATCH KIDS, and licensed Jesmar, S.A. to manufacture and distribute the dolls in Spain. The defendant, Granada Electronics, imported the Spanish Cabbage Patch Kids dolls into the United States. The dolls' "birth certificates" and "adoption papers" were in Spanish and could not be processed by the U.S. trademark owner's fulfillment houses in the United States. Thus, the buyers of the gray market dolls could not participate in the "adoption process" that was critical to the dolls' commercial success. On appeal, the Second Circuit affirmed, holding that the material differences between the authorized U.S. dolls and unauthorized foreign dolls created consumer confusion over the source of the dolls and diminished the plaintiff's goodwill. Even though the dolls bore genuine trademarks and were manufactured under license, they were not "genuine" goods; therefore, the sale of the dolls infringed the plaintiff's U.S. trademark.

The material differences standard, as articulated by the *Original Appalachian Artworks* court and as expanded upon by later courts, is based upon the assumption that consumers associate a trademark with goods having certain characteristics. These consumers are likely to be confused or deceived by goods bearing the same mark but having characteristics suf-
ciency different that they would likely influence the purchase decision.124 This confusion or deception can also erode the goodwill created by the U.S. mark holder.125 As the Third Circuit explained:

When the products sold by the alleged infringer and the trademark owner contain identical marks but are materially different, consumers are likely to be confused about the quality and nature of the trademarked goods. Characteristics of the alleged infringer's goods that are not shared by the trademark owner's goods are likely to affect consumers' perception of the desirability of the owner's goods. Sales of the alleged infringer's goods will tarnish the "commercial magnetism" of the trademark, injuring the trademark owner. In such circumstances, the alleged infringer's goods are considered "non-genuine" and the sale of the goods constitutes infringement.126

As the cases demonstrate, the material differences test rests on the same foundation of prevention of consumer confusion and protection of the trademark owner's goodwill that underlies traditional trademark infringement.127

The material differences standard assumes that when the unauthorized, imported goods are identical to the U.S. goods (for example, are of the same grade and quality, contain the same ingredients or components, and

124 See PepsiCo, Inc. v. Pac. Produce, Ltd., No. 99-1326-PMP-RLH, 2000 U.S. Dist. LEXIS 12085, at *6 (D. Nev. May 4, 2000) ("The sale of gray market goods ... violates the Lanham Act ... because it is likely to confuse consumers as to source, nature, or approval for sale, of these products."). Note that no showing of actual customer confusion is required; rather, the showing of "a material difference between goods simultaneously sold in the same market under the same name creates a presumption of consumer confusion as a matter of law." Societe des Produits Nestle, S.A.v. Casa Helvetia, Inc., 982 F.2d 633, 640 (lst Cir. 1992).

125 See Nestle, 982 F.2d at 638 ("[T]he unauthorized importation and sale of materially different merchandise violates Lanham Act section 32 because a difference in products bearing the same name confuses consumers and impinges on the local trademark holder's goodwill"); see also Gamut Trading Co. v. U.S. Int'l Trade Comm'n, 200 F.3d 775, 779 (Fed. Cir. 1999) (noting that "the consuming public, associating a trademark with goods having certain characteristics, would be likely to be confused or deceived by goods bearing the same mark but having materially different characteristics; this confusion or deception would also erode the goodwill achieved by the United States trademark holder's business"); Iberia Foods Corp. v. Romeo, 150 F.3d 298, 303 (3d Cir. 1998) ("The purpose of the material differences test is to determine whether the allegedly infringing products are likely to injure the goodwill developed by the trademark owner in the trademarked goods.").

126 Iberia Foods, 150 F.3d at 303 (citations omitted). The court stated: "The purpose of the material differences test is to determine whether the allegedly infringing products are likely to injure the goodwill developed by the trademark owner in the trademarked goods." Id.

127 See supra notes 93-94 and accompanying text. See also Gamut Trading Co., 200 F.3d at 783 ("[T]rademark law as applied to gray market goods embodies a composite of likelihood of consumer confusion as to the source of the goods, likelihood of consumer confusion arising from differences between the foreign and the domestic goods, impositions on the goodwill and burdens on the integrity of the United States trademark owner due to consumer response to any differences, and recognition of the territorial scope of national trademarks.").
carry the same warranties and service commitments) and bear the same true mark, consumers will not be confused as to the source or origin of the goods and the U.S. mark holder's goodwill will not be eroded. As the Ninth Circuit put it, "trademark law generally does not reach the sale of genuine goods bearing a true mark even though such sale is without the mark owner's consent," explaining that "trademark law is designed to prevent sellers from confusing or deceiving consumers about the origin or make of a product, which confusion ordinarily does not exist when a genuine article bearing a true mark is sold."129 For example, in Weil Ceramics & Glass, Inc. v. Dash, the Third Circuit held that because there was no risk of consumer confusion or injury to the trademark owner's goodwill, the importation and sale by a third party of authentic LLADRO figurines identical to those imported by the U.S. trademark holder did not infringe the LLADRO trademark.130 Similarly, in American Circuit Breaker Corp. v. Oregon Breakers, Inc., the court found no infringement where the parties stipulated that the allegedly gray market circuit breakers were identical in specification and quality and exhibited only non-material differences in color.131 The material differences test also implicates the first sale doctrine and exhaustion of trademark rights.132 Under the first sale doctrine, once a trade-

128 NEC Elecs. v. CAL Circuit Abco, 810 F.2d 1506, 1509 (9th Cir. 1987); see also Polymer Tech. Corp. v. Mimran, 975 F.2d 58, 61--62 (2d Cir. 1992) ("As a general rule, trademark law does not reach the sale of genuine goods bearing a true mark even though the sale is not authorized by the mark owner. Thus, a distributor who resells trademarked goods without change is not liable for trademark infringement." (citations omitted)); RESTATEMENT (THIRD) OF UNFAIR COMPETITION § 24 cmt. b (1995) ("[T]he trademark owner cannot ordinarily prevent or control the sale of goods bearing the mark once the owner has permitted those goods to enter commerce. It can be said that the rights of the trademark owner are exhausted once the owner authorizes the initial sale of the product under the trademark . . . .").

129 NEC Elecs., 810 F.2d at 1509.

130 Weil Ceramics & Glass, Inc. v. Dash, 878 F.2d 659, 672 (3d Cir. 1989) (noting that "neither of the [policy] goals [of prevention of consumer confusion or injury to goodwill] is undermined by the importation of genuine goods" because consumers "get precisely what they believed that they were purchasing"); see also Nestle, 982 F.2d at 641 ("[W]hen a product identical to a domestic product is imported into the United States under the same mark, no violation of the Lanham Act occurs").

131 Am. Circuit Breaker Corp. v. Oregon Breakers, Inc., 406 F.3d 577, 585 (9th Cir. 2005). Though color differences may be material with regard to certain consumer products, the court did not find that would influence the purchase decision on circuit breakers.

132 The first sale doctrine is also found in copyright law, and it is codified in the Copyright Act. See 17 U.S.C. § 109(a) (2000) ("[T]he owner of a particular copy or phonorecord lawfully made under this title, or any person authorized by such owner, is entitled, without the authority of the copyright owner, to sell or otherwise dispose of the possession of that copy or phonorecord."). The rationale behind the first sale doctrine is that after the first sale of a lawful product, "the policy favoring a copyright monopoly for authors gives way to policies disfavoring restraints of trade and limitations on the alienation of personal property . . . ."; see also Martin's Herend Imps., Inc. v. Diamond & Gem Trading USA, Co., 112 F.3d 1296, 1303 (5th Cir. 1997) (quoting Parfums Givenchy, Inc. v. C&C Beauty Sales, Inc., 832 F. Supp. 1378, 1388 (C.D. Cal. 1993)). The first sale doctrine in trademark law rests on similar policy considerations. Id.
mark owner makes his or her first authorized sale of a trademarked item, the owner has exhausted his or her trademark rights in the item sold. Therefore, a subsequent sale of the product by a third party will not constitute trademark infringement, even if the sale is not authorized by the trademark owner.

As discussed above, see supra note 28 and accompanying text, the doctrine of exhaustion developed in the context of the universality theory. Once the universality theory was supplanted by the territoriality theory, however, the first sale doctrine required modification, for the territoriality theory would have little meaning if once a foreign manufacturer placed its product into the stream of commerce its trademark rights were universally exhausted. Weil, 878 F.2d at 677 n.5 (Becker, J., concurring). Rather, "[t]he more coherent way to view exhaustion in the context of the territoriality theory is to view it as applying individually to each markholder such that a markholder only exhausts its own trademark rights upon sale of the item, and not the trademark rights of other markholders in other countries." Id.; see also Darren E. Donnelly, Comment, Parallel Trade and International Harmonization of the Exhaustion of Rights Doctrine, 13 Santa Clara Computer & High Tech L.J. 445 (1997) (describing the exhaustion doctrine).

The U.S. Supreme Court addressed the application of the first sale doctrine to a gray market case brought under the Copyright Act. In Quality King Distributors, Inc. v. L'Anza Research International, Inc., 523 U.S. 135 (1998), L'Anza Research challenged the unauthorized sale of its hair products. L'Anza held a copyright on the labels placed on the packaging, and it argued that the domestic resale of the containers containing the labels violated its exclusive right to distribute copies of its labels. The Copyright Act makes unauthorized importation of copyrighted works illegal. The Supreme Court rejected this argument, stating that under the "first sale" doctrine, the copyright owner's exclusive right to sell a work stops with the first sale of that work. The Court stated: "[O]nce the copyright owner places a copyrighted item in the stream of commerce by selling it, he has exhausted his exclusive statutory right to control its distribution." Id. at 152.

133 See, e.g., Iberia Foods Corp. v. Romeo, 150 F.3d 298, 301 n.4 (3d Cir. 1998) ("According to the ‘first sale’ or ‘exhaustion’ doctrine, a trademark owner’s authorized initial sale of its product into the stream of commerce extinguishes the trademark owner’s rights to maintain control over who buys, sells, and uses the product in its authorized form.").

134 See Sebastian Int’l, Inc. v. Longs Drug Stores Corp., 53 F.3d 1073, 1074 (9th Cir. 1995) ("[T]he right of a producer to control distribution of its trademarked product does not extend beyond the first sale of the product. Resale by the first purchaser of the original article under the producer’s trademark is neither trademark infringement nor unfair competition."). This is also the position taken by the Restatement (Third) of Unfair Competition:

[T]he trademark owner cannot ordinarily prevent or control the sale of goods bearing the mark once the owner has permitted those goods to enter commerce. It can be said that the rights of the trademark owner are exhausted once the owner authorizes the initial sale of the product under the trademark or that the owner implicitly licenses others to further market the goods under the mark.

Restatement (Third) of Unfair Competition § 24 cmt. b (1995); see also Davidoff & Cie, S.A. v. PLD Int’l Corp., 263 F.3d 1297, 1301 (11th Cir. 2001) ("The resale of genuine trademarked goods generally does not constitute infringement. This is for the simple reason that consumers are not confused as to the origin of the goods: the origin has not changed as a result of the resale.” (citations omitted)).
While the first sale doctrine protects the sale of genuine goods bearing true marks, materially different goods are not considered genuine goods. Unauthorized importers are not the “first seller,” as they have purchased and sold the goods in contravention of policy or agreement, and the resale of gray market goods is not shielded by the first sale doctrine.

B. Identifying a “Material” Difference

When is a difference “material”? The courts straddle a fine line in making this determination. “Minimal” differences clearly will not support a gray market claim. According to the Third Circuit, “when the differences between the products prove so minimal that consumers who purchase the alleged infringer's goods 'get precisely what they believed that they were purchasing,' consumers' perceptions of the trademarked goods are not likely to be affected by the alleged infringer's sales.” However, as the First Circuit explained, consumers may be misled by subtle differences, so “the threshold of materiality must be kept low enough to take account of potentially confusing differences—differences that are not blatant enough to make it obvious to the average consumer that the origin of the product differs from his or her expectations.” The First Circuit went on to state: “Any higher threshold would endanger a manufacturer's investment in

135 See supra notes 120-22 and accompanying text. See also Davidoff & Cie, 263 F.3d at 1302 (The first sale “doctrine does not hold true ... when an alleged infringer sells trademarked goods that are materially different than those sold by the trademark owner.”); Martin's Herend Imps., Inc., 112 F.3d at 1303 (noting the first sale doctrine “applies only to identical genuine goods”); Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F.2d 633, 638 (1st Cir. 1992) (“Trademark law generally does not reach the sale of genuine goods bearing a true mark even though such sale is without the mark owner's consent,” but the court also noted that this “maxim does not apply when genuine, but unauthorized, imports differ materially from authentic goods authorized for sale in the domestic market.” (citations omitted)); Bulova Corp. v. Bulova do Brasil Com. Rep. Imp. & Exp. Ltda., 144 F. Supp. 2d 1329, 1330 (S.D. Fla. 2001) (first sale doctrine protects resellers of genuine merchandise lawfully acquired, but only “where there is no other conduct of infringement”); 4 McCarthy, supra note 24, § 29:51.2 (“This is only logical, because if one applied the ‘first sale’ or ‘exhaustion’ defense to gray goods sales, the unauthorized importer would never be an infringer, because an unauthorized importer is always a reseller of goods.”).

136 Martin's Herend Imps., 112 F.3d at 1303 (“[A]pplying the first sale rule to an unauthorized importer ... would mean that the gray-market importer would always escape liability. Unauthorized importers are never the first seller.”); see also Osawa & Co. v. B & H Photo, 589 F. Supp. 1163, 1174 (S.D.N.Y. 1984) (“[W]here ... the U.S. assignee has developed a separate goodwill factually independent from that of the mark originator, whatever exhaustion occurred with the original release into commerce was the exhaustion of a legally distinct and factually different mark.”).

137 Iberia Foods, 150 F.3d at 303 (quoting Weil, 878 F.2d at 672).

138 Nestle, 982 F.2d at 641; see also Davidoff & Cie, 263 F.3d at 1302 (“Because a myriad of considerations may influence consumer preferences, the threshold of materiality must be kept low to include even subtle differences between products.”).
product goodwill and unduly subject consumers to potential confusion by severing the tie between a manufacturer's [sic] protected mark and its associated bundle of traits.' \(^{139}\) However, all or substantially all of the alleged gray market goods must bear the material differences in order for a cause of action to lie. \(^{140}\)

Ultimately, the threshold for "materiality" is based upon considerations of consumer protection and support for the integrity of the trademarks of U.S. trademark holders. Essentially, the courts look to see whether consumers would likely consider the difference to be relevant when purchasing a product. \(^{141}\) The plaintiff need only show that consumers would be likely to consider the differences between the foreign and domestic products to be significant or relevant when purchasing the product; the plaintiff need not bring in evidence of actual consumer confusion. \(^{142}\) Rather, a presumption of consumer confusion is triggered whenever the difference between the genuine product and the allegedly gray market product is such that a consumer would likely consider it relevant in a purchasing decision. \(^{143}\) The defendant may attempt to rebut the presumption, but to be successful, he or she must prove by a preponderance of the evidence that the differences are not of the type that average consumers would likely consider when making a purchase decision. \(^{144}\)

It is impossible to create a definitive list of what constitutes a "material difference." \(^{145}\) It is clear, however, that the differences need not be

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\(^{139}\) Nestle, 982 F.2d at 641.


\(^{141}\) See Nestle, 982 F.2d at 641; see also Davidoff & Cie, 263 F.3d at 1302 ("A material difference is one that consumers consider relevant to a decision about whether to purchase a product.").

\(^{142}\) Nestle, 982 F.2d at 640 (noting that "a showing of actual confusion is not required").

\(^{143}\) Id. at 641 ("We conclude that the existence of any difference between the registrant's product and the allegedly infringing gray good that consumers would likely consider to be relevant when purchasing a product creates a presumption of consumer confusion sufficient to support a Lanham Trade-Mark Act claim.").

\(^{144}\) Id.

\(^{145}\) See Iberia Foods Corp. v. Romeo, 150 F.3d 298, 304 (3d Cir. 1998) ("Because consumer preferences are as fickle and diverse as the human imagination, it is impossible to devise an exhaustive list of the types of differences between products that can be considered material for the purposes of the genuineness test."). The Customs Services has provided a non-exhaustive list of material differences for Lever Rule protection purposes. 19 C.F.R. § 133.2(e) (2005) states, in relevant part:

"Customs determination of physical and material differences may include, but is not limited to, considerations of:

1. The specific composition of both the authorized and gray market product(s) (including chemical composition);

2. Formulation, product construction, structure, or composite
The types of differences courts have deemed to be material are discussed below. These include differences in ingredients and aesthetic characteristics, quality and quality control measures, warranties, and labels or other written materials accompanying the product.

1. Differences in Ingredients, Aesthetics, and Packaging.—Perhaps the easiest gray market cases are those where the unauthorized goods contain ingredients different from those found in the authorized goods. For example, the court in Grupo Gamesa S.A. v. Dulceria El Molino, Inc. easily found that a material difference existed where the authorized product (crackers) contained enriched flour, and the gray market product did not. Similarly, in Societe Des Produits Nestle, S.A. v. Casa Helvetia, Inc., the First Circuit determined that the foreign owner of the United States trademark PERUGINA and its Puerto Rican subsidiary that imported Italian-made PERUGINA chocolate could prevent the importation of PERUGINA chocolate made under license in Venezuela because the two products were materially different in price, taste, and presentation; were subject to different quality control measures; and were made using different ingredients.

Purely aesthetic differences between the authorized and unauthorized goods can support a gray market claim. For example, in Martin's Herend product components, of both the authorized and gray market product;

(3) Performance and/or operational characteristics of both the authorized and gray market product;

(4) Differences resulting from legal or regulatory requirements, certification, etc.;

(5) Other distinguishing and explicitly defined factors that would likely result in consumer deception or confusion as proscribed under applicable law.

See supra notes 87–88 and accompanying text for a discussion of the Lever Rule.

See Nestle, 982 F.2d at 639 n.7 (“We think that the appropriate test should not be strictly limited to physical differences. Other sorts of differences—differences in, say, warranty protection or service commitments—may well render products non-identical in the relevant Lanham Trade-Mark Act sense”); see also SKF USA Inc. v. Int'l Trade Comm'n, 423 F.3d 1307, 1313 (Fed. Cir. 2005) (concluding that “material differences that preclude infringement by gray goods may be physical or nonphysical”) (decided under § 337 of the Tariff Act of 1930), cert. denied, 126 S. Ct. 2968 (2006).


148 Nestle, 982 F.2d at 642–43.
Imports, Inc. v. Diamond & Gem Trading USA, Co., the Fifth Circuit held that the foreign owner of a U.S. trademark and a domestic distributor could prevent the importation of authentic HEREND porcelain that was materially different in color, pattern, or shape from the HEREND porcelain authorized for sale in the United States. The court stated that "[a]s a matter of law, [aesthetic] differences are material, since consumer choices for such artistic pieces are necessarily subjective or even fanciful, depending on each consumer's personal artistic tastes." This was true even though the differences in the color, pattern, or shape of the porcelain figurines would be readily apparent to an observer if the products were placed side-by-side.

Alteration of packaging or the exterior appearance of the product can create a material difference, even if the product itself is unchanged. In Davidoff & Cie, S.A. v. PLD International Corp., the Eleventh Circuit found that a material difference existed when the defendant made changes to fragrance bottles and packaging. The defendant acquired fragrances intended for sale overseas or in duty-free shops and, in an admitted attempt to prevent the mark owner from identifying the defendant's source, covered the original codes on the box bottoms with white stickers and obliterated batch codes on the bottles with an etching tool. The bottles were then distributed through discount retail stores in the United States. The court found that etching the bottle to remove the batch code degraded the appearance of the bottle and might well lead a consumer to believe "that the bottle had been tampered with." Because the marketing of a fragrance involves not only the product itself but the "commercial magnetism" of the mark affixed to the bottle, the alteration of the physical appearance of the bottle could adversely affect the U.S. mark holder's goodwill and create a likelihood of customer confusion. Consequently, this alteration was a material difference that would support a trademark infringement action.

Similarly, in Montblanc-Simplo GMBH v. Staples, Inc., the fact that the gray marketer physically scarred the product and removed gold plating in obliterating serial numbers on the product was found to be a material difference that could lead to consumer confusion. However, the degree of

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150 Martin's Herend Imps., Inc. v. Diamond & Gem Trading USA, Co., 112 F.3d 1296 (5th Cir. 1997).
151 Id. at 1302.
152 See also Gamut Trading Co. v. U.S. Int'l Trade Comm'n, 200 F.3d 775, 781 (Fed. Cir. 1999) ("[D]ifferences that may be readily apparent to consumers may nevertheless be material."). See generally Martin's Herend Imps., Inc. v. Diamond & Gem Trading USA, Co., 112 F.3d 1296.
153 Davidoff & Cie, SA v. PLD Int'l Corp., 263 F.3d 1297 (11th Cir. 2001).
154 Id. at 1299.
155 Id. at 1303.
156 Id.
157 Id. at 1304.
alteration of the mark appears to be critical to the determination of a material difference. In two other cases, the removal of batch codes on bottles was done so imperceptibly that the bottles were not defaced, and the courts found no material differences existed.\(^\text{159}\)

2. Differences in Quality and Quality Control Measures.—The law protects the right to control the quality, not the actual quality of the goods themselves.\(^\text{160}\) Material differences can arise where the unauthorized goods are of equal, or even higher, quality than the authorized goods. Thus, the only relevant question is whether the goods are materially different, not whether they are of lesser quality. Even higher quality will not excuse a gray market good.\(^\text{161}\)

Material differences can arise where the products are not manufactured and distributed under the quality controls established by the U.S. trademark owner.\(^\text{162}\) As the Second Circuit stated in *El Greco Leather Products Co. v. Shoe World, Inc.*: "One of the most valuable and important protections afforded by the Lanham Act is the right to control the quality of the goods manufactured and sold under the holder's trademark."\(^\text{163}\) According to the

\(^\text{dismissed, 175 F. Supp. 2d 95 (D. Mass 2001).}\)


\(^\text{160 See El Greco Leather Prods. Co. v. Shoe World, Inc., 806 F.2d 392, 395 (2d Cir. 1986) ("[T]he actual quality of the goods is irrelevant; it is the control of quality that a trademark holder is entitled to maintain.").}\)

\(^\text{161 See Iberia Foods Corp. v. Romeo, 150 F.3d 298, 304 (3d Cir. 1998) (noting that the trademark holder need not show that the authorized goods are of a higher quality than the alleged gray market goods); Martin's Herend Imps., Inc. v. Diamond & Gem Trading USA, Co., 112 F.3d 1296, 1302 (5th Cir. 1997) ("[T]he plaintiff need not prove that the defendant's imports are of inferior quality to establish trademark infringement, only that they are materially different.").}\)

\(^\text{162 See Grupo Gamesa S.A. v. Dulceria El Molino, Inc., 39 U.S.P.Q.2d (BNA) 1531 (C.D. Cal. Apr. 9, 1996); Helene Curtis, Inc. v. Nat'l Wholesale Liquidators, Inc., 890 F. Supp. 152, 157 (E.D.N.Y. 1995); El Greco Leather Prods., 806 F.2d 392. But see Monte Carlo Shirt, Inc. v. Daewoo Int'l (Am.) Corp., 707 F.2d 1054, 1058 n.5 (9th Cir. 1983) (finding no possibility of consumer confusion and no material difference where the trademark-holder's quality control measures were met and the goods were identical to what consumers expected to purchase); but cf. Enesco Corp. v. Price/Costco Inc., 146 F.3d 1083, 1087 (9th Cir. 1998) (involving unauthorized domestic goods, not parallel imports); Polymer Tech. Corp. v. Mimran, 37 F.3d 74, 78-79 (2d Cir. 1994) (same); Shell Oil Co. v. Commercial Petroleum, Inc., 928 F.2d 104, 107 (4th Cir. 1991) (same).}\)

\(^\text{163 El Greco Leather Prods., 806 F.2d at 395 (finding goods that had not been inspected to ensure quality were not genuine). In El Greco Leather Products, the goods had been manufactured abroad by agreement of the U.S. trademark holder. The goods were then imported into the United States for sale despite their not having been inspected in accordance with the procedures set forth by the mark holder.}\)
First Circuit, "substantial variance in quality control ... creates a presumption of customer confusion as a matter of law."  

However, the quality control measures must be real, not mere window-dressing, in order to satisfy the material differences standard. For example, in *CPC International, Inc. v. Blandito Food Distributing Corp.*, where the content of the unauthorized goods (corn oil) was identical to the authorized goods and there was no evidence that the mark holder ever inspected the containers of either the domestic or the foreign products once they left the manufacturing plant, no material difference arose. Similarly, in *Iberia Foods Corp. v. Romeo*, the Third Circuit rejected the contention that the trademark owner's superficial inspection of the packaging of authorized imports of a household cleaner constituted a material difference. The trademark owner had no knowledge of the contents or ingredients of the product, and so the owner limited its inspection to "self-evident" defects. The court stated that the trademark owner's "hands off" approach had reduced its quality control inspection to a de minimis check designed to make sure the products involved were not obviously unmarketable. Because distributors and retailers already have incentives to prevent obviously defective goods from reaching the hands of consumers, the Third Circuit reasoned that the limited inspection done by the trademark holder did not create a material difference between the authorized and unauthorized goods.

The quality control implications of unauthorized distribution of the product can also lead to a material difference. In *Bayer Corp. v. Custom School Frames, LLC*, for example, the fact that gray market flea-control products were distributed on-line directly to consumers, without consultation with a licensed veterinarian as required for the sale of the authorized goods, was deemed a material difference. Similarly, in *PepsiCo, Inc. v. Pa-


165 *Iberia Foods*, 150 F.3d at 304 ("[Quality control'] is not a talisman the mere utterance of which entitles the trademark owner to judgment.").


167 *Iberia Foods*, 150 F.3d at 305.

168 *Id.*

169 *Id.*

170 *Id.*

171 Bayer Corp. v. Custom Sch. Frames, LLC, 259 F. Supp. 2d 503, 508 (E.D. La. 2003);
cific Produce, Ltd., the court found material differences in quality control where unauthorized products were sold outside authorized distribution channels because the mark holder was unable "to properly and sufficiently exercise quality control such as . . . placing 'drink by' notice dates on the [unauthorized] product, monitoring the [unauthorized] product for proper shipment and storage conditions, proper arrangement of retail [unauthorized] product displays and rotating stale, damaged or substandard quality [unauthorized] product off the retail shelves." Likewise, in Philip Morris, Inc. v. Allen Distributors, Inc., the mark holder's quality control program, which consisted of visiting authorized distributors to inspect products for damage, staleness, or other quality issues, was improperly subverted when the goods were sold through non-authorized channels.

By contrast, in American Home Products v. Reliance Trading Co., no material differences were found when non-prescription health care products were shipped abroad, then imported back into the United States. The court noted that the products were manufactured for the U.S. market, were inspected and approved by the FDA, were undamaged in transit, and were still in their original sealed packaging. The mere transshipment of the goods, standing alone, did not constitute a material difference. The court in PepsiCo, Inc. v. Giraud, on the other hand, found that "the possible ill effects on the packaging due to transhipment [sic] without adequate provisions for inspections" created a material difference in products authorized for sale in Venezuela but diverted for sale in Puerto Rico.

3. Differences in Labeling, Manuals, and other Written Materials.—Differences in labeling, instruction manuals, and other written materials may be material even where the difference is so striking as to be obvious to a relatively oblivious consumer, such as a label or manual being written in a foreign language. The Federal Circuit addressed this issue in 1999 in Gamut Trading Co. v. U.S. Int'l Trade Comm'n, 200 F.3d 775, 781–82 (Fed. Cir. 1999) (foreign language "instructional and warning labels, operator manuals, and service manuals" were materially different); Ferrero U.S.A., Inc. v. Ozak Trading Inc., 753 F. Supp.

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175 Id. at 1760–62.

176 Id. at 1761 ("[T]he fact that the goods have traveled overseas in no way renders them materially different. At most, the goods have lost part of their shelf-life . . . .").

177 PepsiCo, Inc. v. Giraud, 7 U.S.P.Q.2d (BNA) 1371, 1373 (D.P.R. Mar. 17, 1998). Other material differences cited by the court were the differences in can size and interference with local promotional advertising campaigns. Id.

The defendant had imported used Kubota tractors from Japan for sale in the United States. These tractors had Japanese-language instructional and warning labels, operator manuals, and service manuals. The court noted that while the foreign-language labels would be obvious to a U.S. consumer, the consumer might not realize that he or she was not purchasing an authorized tractor or that parts and service were not available for the tractors from Kubota-US dealerships. Subsequent remedial measures by the importer will not overcome a finding of material differences if those differences existed at the time of importation. For example, placing English-language labels on tractors after importation did not negate the fact that material differences existed at the time of importation. Similarly, in Bourdeau Bros., Inc. v. United States International Trade System, the Federal Circuit noted that the allegation of material differences caused by the inclusion of foreign language operators manuals was not overcome by the seller providing English-language manuals to purchasers of gray market harvesters; rather, it "serve[d] to heighten confusion" as the foreign- and English-language manuals contained differing information as a result of other differences between the products produced for the two markets.

Even the use of non-American spellings of English-language words has been found to be a material difference. In Novartis Animal Health U.S. Inc. v. L.M. Connelly & Sons, Pty. Ltd., labels that "were tailored to medicines for sale in Australia, as shown by use of Australian spellings, use of the metric system, and inclusion of information pertaining to the Australian market,"

were found to create material differences. However, in *CPC International, Inc. v. Blandito Food Distributing Corp.*, the court found no material difference where an English-language label was added to the rear of containers of corn oil originally intended for the Puerto Rican market. The court found no evidence that consumers were confused or misled by the packaging and, in fact, found evidence that dual-language containers were beneficial to Hispanic consumers.

Clearly, the unavailability of a warranty is a material difference—a consumer who anticipated receiving the warranty afforded authorized goods but who received no warranty or a limited warranty as a result of purchasing gray market goods would certainly be disappointed. However, in *Montblanc-Simplo GMBH v. Staples, Inc.*, the court found no material difference where the seller of unauthorized goods matched the warranty offered by the mark owner.

While the lack of a warranty is a fairly obvious difference, other differences between authorized and unauthorized goods may be more subtle. In *Philip Morris, Inc. v. Allen Distributors, Inc.*, the defendant had distributed unauthorized Marlboro cigarettes in the United States. While the unauthorized cigarettes themselves were identical to those produced by the U.S. trademark holder, the packaging for the foreign Marlboros did not contain the Universal Product Codes (UPCs) used on the domestic packaging that permitted the consumer to participate in a merchandise redemption program. This difference was considered material enough to support the grant of a preliminary injunction to the plaintiff. Other differences in the packaging, however, including the inclusion of the phrase “U.S. Tax

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187 *Id.* at 638.
189 Montblanc-Simplo GMBH v. Staples, Inc., 172 F. Supp. 2d 231, 240-41 & n.10 (D. Mass. 2001). The seller did not provide the mark owner’s service manual as a result of a settlement agreement reached with the mark owner in a previous copyright infringement action. *Id.* at 240. The court did find other material differences existed in the “appearance and integrity of the products” and the impact on the mark owner’s “ability to maintain quality control.” *Id.* at 241.
191 In fact, the unauthorized cigarettes were manufactured in the United States by an affiliated company. The court noted that the goods at issue had been manufactured in the United States rather than abroad as would be typical in a gray market case. While that fact “casts some doubt on the viability” of the mark holder’s claims, the court found it did not prevent the issuance of a preliminary injunction. *Id.* at 852.
192 *Id.* at 853. The court also noted that the goods were not subject to the plaintiff’s quality control measures. *Id.* at 848.
Exempt for Use Outside the U.S.” and the use of the name “Philip Morris Products, Inc.” instead of “Philip Morris, Inc.” were considered not to be material because the court deemed them to be unlikely “to affect consumers’ expectations.”

Finally, the courts have found gray market goods whose labels do not comply with state or federal labeling requirements to be materially different. In Bayer Corp. v. Custom School Frames, LLC, gray market flea-control products that did not display an EPA registration number as required by federal law were deemed materially different.

IV. CONCLUSION

As noted above, there are competing policy arguments for prohibiting or allowing the importation and sale of gray market products. Manufacturers and distributors argue that they should be able to control the use of their marks, that gray market goods diminish the value of their marks, that economic benefit from legal exclusive distribution arrangements is undercut by gray market goods, that gray marketers provide unfair competition that free-rides on marketing and advertising expenditures made by legitimate sellers, and that consumers may be misled and disappointed by gray market goods. In short, they argue that gray market goods undercut the twin goals of the Lanham Act—preventing consumer confusion and protecting the mark holder’s goodwill. Those sitting on the other side of the gray market fence argue that consumers benefit from the price competition created by gray market goods, that gray market goods are genuine and bear legitimate marks, and that consumers are not confused as to the source or origin of the goods purchased.

While an in-depth analysis of these policy arguments is beyond the scope of this Article, it is interesting that Congress has not seen fit to ad-

193 Id. at 853 n.10; see also PepsiCo, Inc. v. Pac. Produce, Ltd., No. 99-1326-PMP-RLH, 2000 U.S. Dist. LEXIS 12085, at *4 (D. Nev. May 4, 2000) (material differences existed where unauthorized product did not inform purchasers of or allow purchasers to participate in promotions based on purchases of specially-marked authorized goods).


195 See supra notes 12–16 and accompanying text.
address these policy arguments legislatively. No statute clearly governs the
sale of gray market goods. Instead, current statutory provisions provide an
incomplete patchwork scheme of protection for U.S. mark holders seeking
protection from gray market products. Two of these provisions—Section
526 of the Tariff Act and Section 42 of the Lanham Act—create mecha-
nisms to bar the importation of prohibited goods. Two other provisions—
Sections 32 and 43 of the Lanham Act—provide remedies for trademark
infringement caused by the sale of gray market goods. None of these sec-
tions were specifically written with the gray market problem in mind, and
gray market complainants have had to work hard to fit their claims into this
statutory framework.

Despite the uneasy fit, the application of these provisions appears to
have provided a sort of safety valve that has addressed many of the con-
cerns raised by gray market activities and that has prevented the build-up
of the type of pressure necessary to trigger legislative action. Given that
gray market causes of action do not fit neatly into the traditional infringe-
ment paradigms, is the application of these provisions legitimate? In par-
ticular, is the creation and application of the "material differences" stan-
dard appropriate?

The courts have used the material differences standard to allow goods
legally sold under a mark to effectively be treated as if they were in fact un-
authorized goods competing with goods sold under that same mark. Thus,
materially different goods are not subject to the common control exception
to Section 526 of the Tariff Act or the affiliate exception of Section 42 of
the Lanham Act. Similarly, a materially different gray market good can be
deemed to be infringing upon a mark under Sections 32 and 43 of the Lan-
ham Act even though the mark is legally affixed to the gray market good.

Despite this apparent anomaly, the treatment of materially different
gray market goods is consistent with the Lanham Act's traditional focus
on prevention of consumer confusion and protection of the mark holder's
goodwill. The courts have done the best they can to protect consumers and
to provide relief to holders of U.S. registered marks given the imprecise
and incomplete statutory scheme within which they must act.

For the mark holder, the lesson seems to be that it may achieve some
measure of protection from gray market goods by contractually requiring
material differences in ingredients, aesthetic characteristics, packaging, or
quality in goods licensed for sale outside the United States. By creating a
material difference, the mark holder creates a mechanism for seeking legal
relief in the event that a gray market arises. For the courts, the focus must
be on whether the goals of the Lanham Act are furthered by application
of the material differences standard, or whether the mark holder seeks to
overemphasize differences to obtain a protection from gray market goods
that Congress has not yet been willing to extend.