LITIGATING THE GRAY MARKET: AN INTELLECTUAL PROPERTY APPROACH TO CURTAILING PARALLEL IMPORTS

NOTE

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I. INTRODUCTION

GRAY GOODS ARE PRODUCTS BEARING A VALID TRADEMARK WHICH ARE SOLD by unauthorized distributors in contravention of commercial arrangements. Also referred to as parallel imports, these products are usually obtained abroad and not intended to be resold in the United States.[1] Gray marketers take advantage of existing price differentials between countries and benefit from the goodwill and reputation that the authorized dealer has developed in a particular market. Gray goods are generally understood to be legal, although, to some, they may appear to be unethical. If the gray goods are identical to the authorized products and they are being offered at a lower price, then there is the presumption that the consumer is not being harmed, and therefore, trademark law cannot be applied to bar the sale of these goods. Gray goods are not to be confused with counterfeit products, since they are genuine products, usually produced under a valid license, yet intended for a different market than the one where they are being sold. They also differ from counterfeit products because they are identical or very similar to the authorized products and bear a registered trademark.

Distributors of authorized goods are those most interested in litigating and curtailing the sale of gray goods, since these products compete with theirs and cause them to lose huge profits. The gray market has been described as a multi-billion dollar industry which competes with the authorized distribution system,

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1 Lisa A. Nester, *Keywords, Trademarks, and the Gray Market: Why the Use Is Not Fair*, 7 MARQ. INTELL. PROP. L. REV. 235, 242 (2003).

eating away at its profits.[2] In 2007, for example, the sale of gray market Information Technology products had an average impact on the profits of technology companies of between $8 and $10 billion dollars.[3] Although it may seem as if consumers benefit from gray products, since they are able to purchase the same products for a lower price, the truth is that gray market goods can potentially harm consumers in many ways.

Firstly, consumers may be confused or deceived as to the source or affiliation of the products they are buying. At times, trademark holders confer licenses to producers in foreign countries allowing them to manufacture and sell products under the existing trademark for sale exclusively in that country or region. In such cases, the foreign source of the gray product is not the same as the domestic source whom the consumer associates with the trademark. Furthermore, gray products may not meet the same quality standards with which authorized products are required to comply. When consumers buy gray products, they may be relying on the quality that they know and trust and which they associate with the product's trademark. However, they may instead find themselves with products that were mishandled or damaged as they were exported and imported on multiple occasions, and in the end cause dissatisfaction in the consumer. Additionally, consumers may subsequently find that the products they purchased, because they are unauthorized, are not covered by the manufacturer's warranty. Gray products may also get mixed with counterfeit products or be tampered with in some way. Finally, although gray goods are not counterfeit, there may be small variations, as products intended to be marketed in different regions are usually slightly modified, possibly resulting in incompliance with U.S. safety, ingredient, or labeling requirements.[4] These scenarios not only harm consumers, but also wear down the authorized distributors', as well as the manufacturers', hard-earned goodwill and reputation.

Gray goods also have effects on the market in general. The presence of gray goods causes an increased supply, which, in turn, lowers the price that consumers are willing to pay for the product because it is widely available. This result, if seen in a simplistic manner, may appear as a positive effect of gray goods. However, the long-term effect is that, since profits for manufacturers diminish they may need to lower costs, and consequently begin producing lower quality products. In the end, the consumer is confronted with a decline in the quality of the products, triggered by the presence of gray goods in the market.[5]

The problem with gray goods is clear. Yet, the solutions available to manufacturers and distributors of authorized products who are being affected by

2 *Id.*

3 KPMG AND AGMA GLOBAL, KPMG/AGMA SURVEY PROJECTS GLOBAL 'GRAY MARKET' OF $58 BILLION FOR INFORMATION TECHNOLOGY MANUFACTURERS (2008), http://www.agmaglobal.org/press_events/12-11-08%20KPMG%202nd%20release%20for%20WP.pdf.

4 Nester, *supra* note 1, at 243.

5 *See* Christopher A. Mohr, *Gray Market Goods and Copyright Law: An End Run Around K Mart v. Cartier*, 45 CATH. U. L. REV. 561, 572-573 (1996).

the sale of gray goods are not clear. Although gray marketing is generally understood to be legal, there are several creative approaches that are being taken in order to curtail it, such as litigating the case under certain intellectual property laws.

II. The Trademark Approach

Trademarks are words, phrases, symbols, designs, images, sounds, smells, and colors, among other traits, that distinguish the products of a particular source from those of another. Unlike copyrights and patents, which are constitutionally based,[6] trademarks derive from legislation.[7] Trademark law has a dual purpose: on the one hand, it protects consumers from confusion or mistake about the source of a product or service in the market, while, on the other hand, it protects the reputation and goodwill of the trademark owners, thus, creating an incentive to maintain the quality and consistency of their products.[8] Several trademark law arguments have been used in cases regarding gray goods.

Section 32(1)(a) of the Lanham Trade-Mark Act (the Lanham Act) prohibits and imposes civil liability for the sale, offer for sale, distribution, and advertisement of counterfeit or imitation products due to the likelihood of confusion or deception that it may cause in consumers.[9] Section 32 clearly takes care of counterfeit and imitation products; however, it is not an adequate solution for gray products. Since, as discussed before, gray market products are usually identical or extremely similar to the authorized products, consumer confusion is unlikely, hence, making Section 32 inapplicable to gray products.

Case law has been consistent in holding that trademark law does not protect the unauthorized sale of genuine goods bearing a true mark.[10] This general principle is inapplicable, however, when the "genuine, but unauthorized, imports differ materially from the authentic goods authorized for sale in the domestic market."[11] The reasoning behind this so-called "material differences" standard lies in that differences in products bearing the same name and mark

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6 *See* U.S. CONST. art. I, § 8, cl. 8.

7 *See* Lanham Trade-Mark Act, 15 U.S.C. §§ 1051 *et seq.*; *see also* Puerto Rico Trademark Act, Act Num. 169 of December 16, 2009, 11 L.P.R.A. §§ 171 *et seq.* (2010).

8 *See, e.g.,* Societe des Produits Nestle, S.A. v. Casa Helvetia, Inc., 982 F. 2d 633, 636 (1st Cir. 1992).

9 Lanham Trade-Mark Act § 32, 15 U.S.C. § 1114 (2009) ("(1) Any person who shall, without the consent of the registrant--(a) use in commerce any reproduction, counterfeit, copy, or colorable imitation of a registered mark in connection with the sale, offering for sale, distribution, or advertising of any goods or services on or in connection with which such use is likely to cause confusion, or to cause mistake, or to deceive; or [...]shall be liable in a civil action by the registrant for the remedies hereinafter provided").

10 *See* NEC Electronics v. CAL Circuit Abco, 810 F. 2d 1506, 1508-1509 (1987). *See also* Shell Oil Corp. v. Commercial Petroleum, Inc., 928 F. 2d 104, 107 (4th Cir. 1991).

11 *Nestle*, 982 F. 2d at 638.

contravene Section 32 of the Lanham Act because they "confuse consumers and impinge on the local trademark holder's goodwill."[12] There is no particular standard for determining what are understood to be "material differences," since this analysis depends on the nature of the products. Material differences are thus determined on a case-by-case basis.[13] Section 32 of the Lanham Act may be of help in curtailing some very limited cases of gray market products. However, this approach does not provide a solution for addressing the majority of gray products, which are not materially different from the authorized products.

Another section of the Lanham Act that has been invoked by those trying to restrict the sale of gray products is Section 42,[14] which prescribes that:

> *no article of imported merchandise which shall copy or simulate the name of any domestic manufacture*, or manufacturer, or trader, or of any manufacturer or trader located in any foreign country which, by treaty, convention, or law affords similar privileges to citizens of the United States, *or which shall copy or simulate a trademark registered in accordance with the provisions of this chapter* or shall bear a name or mark calculated to induce the public to believe that the article is manufactured in the United States, or that it is manufactured in any foreign country or locality other than the country or locality in which it is in fact manufactured, *shall be admitted to entry at any customhouse of the United States*.[15]

Section 42 does not distinguish between genuine products and copies or simulations. However, the statute's purpose is, as mentioned above, to protect the consumer from confusion, and no such confusion exists when the two products, the imported and the domestic one, are identical. Again, we are confronted with a statute that only affords protection against counterfeit and imitations and, in rare cases, to gray products.

Trademark law can only afford protection against gray market products if material differences are present to such an extent that they are likely to cause confusion in the consuming public.[16] For this reason, trademark approaches to curtailing gray market products have proved ineffective in most cases. This, in turn, has required more creative theories from lawyers defending domestic manufacturers and distributors from competing parallel imports.

III. CUSTOMS REGULATIONS: THE TARIFF ACT

The United States Tariff Act of 1930 has a clear disposition that bars the importation of goods bearing a valid U.S. trademark without the written

12 *Id.*

13 *See id.*

14 Lanham Trade-Mark Act § 32, 15 U.S.C. § 1124 (2009).

15 *Id.* (emphasis added).

16 *See, e.g., Nestle,* 982 F. 2d at 640.

authorization of the U.S. trademark holder.[17] However, Customs regulations have created broad exceptions to this rule, allowing goods bearing a valid U.S. trademark to enter the country without the trademark holder's consent if: "(1) the United States and the foreign trademark are owned by the same entity; (2) the United States and the foreign mark holders are subject to 'common control'; or (3) the goods bear a mark applied 'under authorization of the U.S. owner.'"[18]

These regulations were specifically interpreted by the U.S. Supreme Court in *K Mart v. Cartier*[19] which distinguishes between three separate scenarios of gray imports, of which only in one may Customs allow the parallel importation. The first situation is where a company purchases the right to use a foreign mark within the U.S. and registers said mark in the U.S. Registry. If the foreign manufacturer tries to import goods bearing that mark into the U.S., taking advantage of the reputation that the company has built in the U.S. for the mark, the importation can be barred, according to the U.S. Supreme Court. If, however, the company that registers the foreign mark in the U.S. is an affiliate of the foreign company, then the importation is allowed because, in the Court's opinion, the U.S. distributor, due to its ties with the foreign producer, is in a position to prevent the importation if it is in fact harming it. The third situation that the court considers is when a U.S. manufacturer, with a registered mark, sells to a foreign company the right to use and sell the mark abroad, with the restriction that it may not import the products bearing the mark into the U.S. If the foreign company breaches the agreement, the U.S. manufacturer and mark holder may require Customs to prevent the importation of the goods. Therefore, the *K Mart* decision is solely based on the type of relationship existing between the U.S. and the foreign mark holders and makes no reference to material differences, as do court decisions made pursuant to trademark law. In conclusion, the Tariff Act may prove useful in certain situations; yet, Customs regulations have created loopholes for gray goods and in the case of goods where the foreign importer and the domestic mark bearer are subject to common ownership, the Tariff Act cannot be applied to prohibit the parallel importation.

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17 Tariff Act of 1930 § 526, 19 U.S.C. § 1526(a) (2009) ("Except as provided in subsection (d) of this section, it shall be unlawful to import into the United States any merchandise of foreign manufacture if such merchandise, or the label, sign, print, package, wrapper, or receptacle, bears a trademark owned by a citizen of, or by a corporation or association created or organized within, the United States, and registered in the Patent and Trademark Office by a person domiciled in the United States, under the provisions of sections 81 to 109 of Title 15, and if a copy of the certificate of registration of such trademark is filed with the Secretary of the Treasury, in the manner provided in section 106 of said Title 15, unless written consent of the owner of such trademark is produced at the time of making entry.").

18 Mohr, *supra* note 5, at 574.

19 K Mart Corporation v. Cartier, Inc., et al., 108 S. Ct. 1811 (1988).

IV. COPYRIGHT LAW: A MORE EFFECTIVE TOOL

The trademark and tariff approaches described above provide solutions for a variety of scenarios involving the importation of gray goods into the U.S. market. However, there remains still one scenario where neither of these approaches results helpful to the trademark owner trying to prevent the sale of gray goods. This is the case where the goods "perfectly mirror[ ] those sold in the United States and [bear] a United States trademark owned by a United States affiliate of a foreign trademark registrant."[20] For these cases, litigants have come up with the novel solution of utilizing copyright law to circumvent the affiliate exception created by *K Mart*.

Copyrights provide protection to "original works of authorship fixed in any tangible medium of expression."[21] Copyright protection is automatic: as long as the work is fixed in a tangible medium of expression, it is not necessary to register the copyright in order to acquire the rights and protections. Registration, however, does provide additional rights and is a prerequisite for upholding an infringement suit. Some of the works covered by copyright law are: literary works, musical works, dramatic works, *pictoral, graphic, and sculptural works*, motion pictures, and architectural works. Obviously, goods subject to a trademark are not automatically protected by copyright law. In order to attain copyright protection for a trademarked good, the good must also meet the requirements for works covered under copyright law. The trademark owner may ensure copyright protection of its goods by making the product, or some part of it, such as the label of packaging, copyrightable. For it to be copyrightable "the work must be in writing or other tangible form from which it can be reproduced [and] it must also be original and involve an appreciable amount of creative effort."[22]

The purposes of copyright protection vary greatly from those of trademarks. Firstly, consumer confusion is generally irrelevant to copyright law. The main goal of copyrights is to allow authors to control the use and sale of their works. This is what makes copyright law particularly attractive as a weapon for fighting gray marketing. The material differences standard does not apply to copyrights, on the contrary, the more identical the infringing goods are to the authorized goods, the more applicable copyright law becomes. Additionally, the existence of an affiliation between the foreign importer and the domestic copyright owner does not act as a restriction that prevents the importation of the infringing goods. According to section 602(a) of the Copyright Act "[i]mportation into the United States, without the authority of the owner of [the] copyright under this title, of copies or phonorecords of a work that have been acquired outside the United States is an infringement of the exclusive right to distribute copies or

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20 Mohr, *supra* note 5, at 586.

21 Copyright Act of 1976, 17 U.S.C. § 102(a) (2009).

22 Donna K. Hintz, *Battling Gray Market Goods with Copyright Law*, 57 ALB. L. REV. 1187, 1191-92 (1994).

phonorecords."[23] The Copyright Act does not authorize Customs to bar the entrance of copyrighted works that contravene Section 602(a), hence, it is up to the U.S. copyright owner to initiate a private infringement suit. The copyright owner's exclusive right to control the distribution of its works is limited, however, by the "first sale doctrine," which arises from section 109(a) of the Copyright Act.[24]

A. First Sale Doctrine

The First Sale Doctrine limits the copyright owner's right to control the resale or subsequent transfers of the copyrighted work after the first sale. This statutory limitation is not clearly drafted, and consequently, has been subject of multiple and diverse interpretations by different courts. Section 109(a) indicates that,

> [n]otwithstanding the provisions of section 106(3) [which gives the copyright owner the exclusive right to do and authorize the distribution of copies of the work], the 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.[25]

The phrase "'[l]awfully made' refers to goods made without violating any laws; for example, goods manufactured with permission as opposed to counterfeit goods."[26] The controversy that has been analyzed by the courts is whether a first sale abroad "of legally manufactured foreign goods which are eventually imported without permission into the United States [in direct contravention to section 602(a)] . . . prevents [the] United States copyright owner from using copyright law to prohibit the importation."[27] The issue is to determine whether the first sale doctrine, embodied in section 109(a), limits section 602(a)'s prohibition of importing unauthorized copyrighted material acquired abroad.

The court decisions regarding this matter can be arranged into two major groups: the first group of cases has prohibited the importation of unauthorized copyrighted works, while the second has allowed it. The main factor that has inspired these decisions is whether the goods were manufactured domestically or abroad. In most cases, the goods produced abroad, even under a valid license, and later imported, were declared as infringing, while those manufactured domestically, sold abroad, and subsequently imported were permitted.

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23 17 U.S.C. § 602(a)(1) (2009).

24 17 U.S.C. § 109(a) (2009).

25 *Id.* (emphasis added).

26 Hintz, *supra* note 22, at 1211.

27 *Id.* at 1187-88.

B. First Sale Doctrine Copyright Case Law

The first gray goods case litigated under copyright infringement was *Nintendo of America v. Elcon Industries*.[28] In this case, Nintendo of America, an affiliate of the Japanese company, owned the U.S. copyright for the game Donkey Kong. Nintendo of America manufactured, sold, and marketed the Donkey Kong arcade video game in the U.S. The Japanese company had authorized Falcon to manufacture and distribute a similar Donkey Kong game, under the Nintendo brand, exclusively in Japan. Falcon, however, apparently violated the agreement, importing the video game consoles into the U.S. Elcon bought the consoles from a U.S. company who had purchased the unauthorized products and began distributing them in the U.S. Nintendo of America sued Elcon under copyright infringement and unfair competition, and requested a preliminary injunction. The district court concluded that Elcon was benefitting from Nintendo of America's goodwill and was causing harm to the latter, and that Nintendo of America proved its likelihood of success on the merits, consequently granting the requested injunctive relief. In its analysis the court does not consider the first sale doctrine, which must lead to the conclusion that in the court's opinion, a first sale abroad does not prevent the copyright owner from banning the importation of copyrighted work, pursuant to section 602(a).

One year after *Nintendo, Columbia Broadcasting v. Scorpio Music,*[29]—one of the most cited gray goods copyright cases—followed. Here, Columbia sued Scorpio for copyright infringement over records for which Columbia was the U.S. copyright holder. The records acquired by Scorpio had been manufactured and sold under a valid, yet limited, license in the Philippines. The Philippine records had made their way into the U.S. and were bought by Scorpio who began distributing them in the U.S. without Columbia's authorization. Scorpio raised the first sale defense and argued that the first sale of the records made in the Philippines prevented Columbia from claiming that Scorpio's sale of the records in the U.S. constituted copyright infringement.

The district court held that section 602(a) was not limited by the first sale doctrine and consequently, that section 109(a) "grants first sale protection to the third party buyer of copies which have been legally manufactured and sold within the United States and not to purchasers of [foreign manufactured] imports such as are involved here."[30] The court's reasoning relied on the principle that U.S. legislation generally does not have extraterritorial application and therefore, the statutorily created first sale doctrine cannot be applied to sales made outside the U.S. borders, absent express Congressional intent. Additionally, the court stated that since section 602(a) was enacted more recently than section 109(a), the effect of interpreting that section 109(a)

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28 Nintendo of America, Inc., v. Elcon Industries, Inc., 564 F. Supp. 937 (D.C. Mich. 1982).

29 Columbia Broadcasting System, Inc. v. Scorpio Music Distributors, Inc., 569 F. Supp. 47 (D.C. Pa. 1983) (affirmed without opinion by 738 F. 2d 424 (3rd Cir. 1984)).

30 *Id.* at 49.

supersedes section 602(a)'s restriction on importation would be that section 602(a) would be rendered virtually meaningless.[31] Such construction of the statute would mean that "[t]hird party purchasers who import phonorecords could thereby circumvent the statute, in every instance, by simply buying the recordings indirectly."[32] This would violate the principle that no part of a statute should be interpreted in a way that makes any other part of the statute superfluous. For the reasons stated, the circuit court granted Columbia's request for summary judgment.

Following the *Columbia Broadcasting* decision, the District Court for the Northern District of California decided in *Hearst v. Stark*[33] that section 109(a) cannot be construed to limit the application of section 602(a) because section 602(a) was enacted after section 109(a), yet, it makes no reference to section 109(a). If Congress intended for section 602(a) to be limited by the first sale doctrine, it would have made this intent explicit within the statute. Therefore, after analyzing the legislative history of these dispositions, the court decided that "section 602 clearly provides that it is an infringement of United States copyrights for books that have been acquired outside the United States, however lawfully, to be imported into the United States."[34] The Ninth Circuit followed this same reasoning in deciding *BMG Music v. Perez*.[35]

Another case that decides against the importation of legally manufactured copyrighted goods produced abroad is *Parfums Givenchy v. C & C Beauty Sales,*[36] yet in this case the court bases it decision in a different rationale. The court agrees with the outcome of the Ninth Circuit in *BMG Music*, to which it is bound. However, it understands that the basis for the decision should be different. As opposed to the cases discussed above, the court here interprets "that the phrase 'lawfully made under this title' clarifies what constitutes a 'first sale' for purposes of the first sale doctrine; it makes no reference to the location of the manufacture or sale of the goods."[37] Instead, the court focuses its discussion on its understanding that "the [section] 106(3) distribution right, the first sale doctrine of [section] 109(a), and [section] 602(a) all work together to enable the copyright owner to realize the 'full value' of each copy sold."[38] In order for a first sale to take place, a valid sale must be made, and according to

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31 *Id.*

32 *Id.*

33 Hearst Corporation v. J. Ben Stark, and J. Ben Stark Books, Inc., 639 F. Supp. 970 (N.D. Cal. 1986).

34 *Id.* at 975.

35 BMG Music v. Perez, 952 F. 2d 318 (9^{th} Cir. 1991) (holding that the first sale doctrine does not provide a defense for infringement under section 602(a) when the infringing copies are manufactured abroad).

36 Parfums Givenchy, Inc. v. C & C Beauty Sales, Inc., 832 F. Supp. 1378 (C.D. Cal. 1993).

37 *Id.* at 1387.

38 Hintz, *supra* note 22, at 1203.

the court, a valid sale only takes place when the owner receives the full value for its product. Therefore, only those who purchase the copy for the full value are afforded the protection of the first sale doctrine. With gray imports, copyright owners are prevented from attaining the full value to which they are entitled; therefore, gray goods violate Copyright law. This argument is one of the strongest that can be made in favor of prohibiting gray imports and hence proves that copyright law is a very useful tool against gray goods.

Parfums Givenchy, however, indirectly renders section 609(a) inapplicable to copies manufactured in the U.S., exported for sale abroad, and later imported back into the U.S. without the authorization of the U.S. copyright owner. The reason for this is because once the copy is sold within the U.S. for the full value, the copyright holder loses the right to control further sales. This leads us to the second group of cases, which have allowed the unauthorized copyrighted work to be imported into the U.S. if it was manufactured in the U.S. and then sold abroad. In *Cosmair v. Dynamite Enterprises*[39] the court decided not to issue the requested preliminary injunction that would have barred the sale of unauthorized imports. The reasoning was that Cosmair was unable to prove its likelihood of success on the merits because if *Nintendo* and *Columbia* were applied to the facts of this case they would render the goods as covered under the first sale doctrine. Here the copies were manufactured in the U.S. and later imported back into the U.S. market without the authorization of the copyright owner. Therefore, the court concluded that section 602 was inapplicable as the first sale had taken place domestically. In *Neutrogena v. United States*[40] the court followed the *Cosmair* decision in denying Neutrogena's request for preliminary injunction because the goods were manufactured in the U.S.

The copyright approach to gray goods received a hard blow with the Third Circuit's decision in *Sebastian v. Consumer Contacts*.[41] In this case the circuit court ruled that the copyright owner lost all rights to control the importation after the first sale was made. The court failed to recognize any conflicts between sections 109(a) and 602(a), consequently applying the first sale doctrine to both foreign and domestically manufactured goods. Additionally, the court concluded that sections 109(a) and 602(a) are separate dispositions and that the first sale doctrine, embodied in section 109(a), applies in all cases of unauthorized importation. This Third Circuit decision is what motivated the Supreme Court to sort out this issue for good.[42]

In 1998, in *Quality King v. L'anza*,[43] the Supreme Court finally decided whether the first sale doctrine is applicable to imported copies, pursuant to

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39 Cosmair, Inc. v. Dynamite Enterprises, Inc., 226 U.S.P.Q. (BNA) 334.

40 Neutrogena Corp. v. United States, 7 U.S.P.Q.2d (BNA) 1900 (1988).

41 Sebastian International, Inc. v. Consumer Contacts (PTY) Ltd., 847 F. 2d 1093 (2nd Cir. 1988).

42 *See* Quality King Distributors, Inc. v. L'anza Research International, Inc., 523 U.S. 135, 140 (1998) ("Because its decision created a conflict with the Third Circuit, see *Sebastian Int'l, Inc. v. Consumer Contacts (PTY) Ltd.,* 847 F.2d 1093 (1988), we granted the petition for certiorari.").

43 *Id.*

section 602(a). L'anza is a manufacturer and distributor of hair care products and affixes copyrighted labels to its products. L'anza distributes its products in the U.S. to select retailers, such as beauty salons and barber shops because its studies have revealed that U.S. consumers were not willing to pay high prices for hair care products if they were sold along with cheaper brands in supermarkets and pharmacies. L'anza has invested considerable effort and money into advertising its products and creating a brand image in the U.S. Outside the U.S., however, L'anza sells its products to distributors at prices significantly lower than in the U.S., in great part because it does not engage in extensive marketing efforts abroad as it does in the U.S. Some products manufactured by L'anza and sold abroad made their way back into the U.S. and were sold by unauthorized retailers who purchased the products from Quality King Distributors.

The Supreme Court explains that sections 109(a) and 602(a) are separate provisions that apply to different situations and that although they may both apply in some situations, the interpretation that one limits the other is not necessary.

> The argument that the statutory exceptions to [section] 602(a) are superfluous if the first sale doctrine is applicable rests on the assumption that the coverage of that section is coextensive with the coverage of [section] 109(a). But since it is, in fact, broader because it encompasses copies that are not subject to the first sale doctrine-*e.g.,* copies that are lawfully made under the law of another country-the exceptions do protect the traveler who may have made an isolated purchase of a copy of a work that could not be imported in bulk for purposes of resale. As we read the Act, *although both the first sale doctrine embodied in § 109(a) and the exceptions in [section] 602(a) may be applicable in some situations, the former does not subsume the latter; those provisions retain significant independent meaning*.[44]

In its decision, the Supreme Court also establishes that the purpose of section 602(a) is to prevent the unauthorized importation of copies manufactured abroad under the laws of a foreign country. In such a case the first sale doctrine does not apply because the wording of section 109(a) provides that the first sale restriction concerns copies "lawfully made under this title" and the copies made abroad, although lawfully made, are not made pursuant to the U.S. Copyright Act.

Quality King confirms the approach taken by most district courts and reverses the Third Circuit's decision in *Sebastian*. The current state of law after the Supreme Court's interpretation in *Quality King* is that copyright holders may initiate and prevail in an infringement action against gray goods manufactured abroad and imported without the authorization of the U.S. copyright owner. Domestically manufactured goods remain, however, without protection when they find their way back into domestic markets, albeit lacking authorization

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44 *Id.* at 148-149 (emphasis added).

from the U.S. copyright owner. This result is due to the applicability of the first sale doctrine embodied in section 109(a) of the Copyright Act.

V. Conclusion

As demonstrated by the outcomes of the cases discussed above, there is a variety of approaches that may be taken in order to battle gray market goods. Firstly, there is the obvious trademark approach. Under the Lanham Act, if the trademark owner can demonstrate that the unauthorized goods exhibit material differences when compared to the authorized products, which will most likely cause confusion in the consuming public, then there is great chance of prevailing. If such is the case, the trademark holder may enjoin the importation of the unauthorized goods or sue for trademark infringement, or both. A wise recommendation for producers of trademarked goods that sell in different countries at different prices is to make sure that the goods have slight, yet tangible differences in each regional market. This will ensure that if they enter the U.S. as gray goods, the trademark holder will be able to support a trademark infringement suit.

If the trademark approach is not available because the goods do not bear material differences that may confuse the consumers, the copyright approach is available in most cases. In order to have a copyright case the manufacturer has to make sure that at least some part of its product, or the packaging, is copyrightable. In copyright cases there need not be material differences; in fact the product should be an identical copy of the copyrighted work. The only limitations in copyright cases are that the copyright owner may not control the distribution of a copy beyond the first sale, and that therefore, domestically manufactured copies that are sold abroad and subsequently make their way back into the U.S. are not protected by the Copyright Act. This exception does not apply, however, to copies produced abroad, even under a valid license, and imported into the U.S. without authorization. Therefore, a recommendation to manufacturers that desire to sell their goods abroad at lower prices than those used domestically, is that they grant licenses that contemplate the production, distribution, and sale abroad, instead of manufacturing the products domestically and then selling them abroad. If the product is manufactured abroad and enters the U.S. market without authorization of the U.S. copyright owner, even if that owner granted a license for use of the copyright abroad, the owner may sue those distributing the unauthorized good for copyright infringement, regardless of how many times the goods have changed hands, because the first sale doctrine never applies to these situations.

Additional methods of battling gray market goods include labeling the products as unauthorized, demarking or removing trademarks from the goods before importation, or raising prices abroad to decrease any incentives for importing.[45] Contractual clauses are also an effective tool, but they usually only provide an action for breach of contract, which does not provide as many remedies as those available in an infringement suit. However, a more creative approach to drafting the contracts may lead to the inclusion of clauses where the parties agree that certain remedies, such as those provided statutorily for trademark or copyright infringement, will apply in the case of unauthorized distribution in violation of the contract. A clause may, for example, establish that distributing the products through unauthorized channels will entail automatic impounding and disposal of the infringing articles by the manufacturer, without having to obtain a protective order or an injunction from a court. As long as these remedies do not contravene any laws and are not immoral, the drafters may include clauses that make it extremely unattractive for the other party to engage in parallel importation.

In conclusion, there are many remedies available for addressing gray marketing and its negative effects for manufacturers, distributors, and consumers. Depending on the nature and characteristics of the products, one may consider a trademark approach, a copyright approach, or a contractual approach in order to deal with the unauthorized distribution of goods. Before initiating an infringement suit, there needs to be an analysis of the good, its appearance, composition, packaging, and country of origin or manufacture, among other characteristics, in order to determine which approach is most desirable.

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45 This last approach may not always be defensible. In the case of expensive products where the consumer invests a considerable amount of money and is subsequently affected, because of the quality of the gray product or inapplicability of a warranty, for example, artificially raising the price of the product in a foreign market may be favored. However, in the case of certain products (i.e. hair care products) where the consumer's investment is not as significant, if the consumer is not satisfied with the product she may dispose of it and never buy it again. In this case, although the producer or distributor and their goodwill are still being harmed, it may not be defensible to hold that artificially raising prices abroad is a feasible solution. The harm to consumers who buy such gray products is not as clear as the potential harm to consumers and the market caused by artificially raising prices.