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Trademark Law: Uncommon Controls over Grey Market

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CASE COMMENT

TRADEMARK LAW: UNCOMMON CONTROLS OVER GREY MARKET

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Appellee, Vittoria North America (VNA), an Oklahoma limited liability company, entered into an assignment agreement with the Italian manufacturer of Vittoria-branded bicycle tires, Vittoria S.p.A. (Vittoria Italy).[1] Through the agreement, Vittoria Italy assigned the U.S. trademark 'VITTORIA,' together with the goodwill of the business, to VNA.[2] Appellant, Euro-Asia Imports (EAI), a California sole-proprietorship, bought genuine Vittoria-branded bicycle tires overseas and imported them into the United States.[3] Appellee brought suit in the U.S. District Court for the Western District of Oklahoma and alleged that EAI violated VNA trademark rights in the VITTORIA mark by importing Vittoria-branded tires into the United States without first obtaining VNA's consent.[4] The district court granted VNA's motion for partial summary judgment and found that the undisputed facts in the case established that section 1526 of the Tariff Act of 1930 entitled VNA to prohibit EAI from importing goods bearing the VITTORIA mark into the United States.[5] The U.S. Court of Appeals for the Tenth Circuit affirmed the judgment of the district court and held, that EAI failed to show any genuine questions of material fact sufficient to implicate the common control exception to the Tariff Act of 1930.[6]

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1. Vittoria N. America, L.L.C. v. Euro-Asia Imports, Inc., 278 F.3d 1076, 1080 (10th Cir. 2001).
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id.*
6. *Vittoria*, 278 F.3d at 1086.

The U.S. Congress enacted section 1526 of the Tariff Act of 1930[7] to control grey market goods.[8] A grey market good is a foreign manufactured good, carrying a valid U.S. trademark, imported into the United States without the consent of the U.S. trademark holder.[9] As grey market goods illegally enter the U.S. market, these goods compete with goods of the same brand which the U.S. trademark holder lawfully imported into the United States.[10] Thus, the prototypical victim of a grey market is a domestic company that purchases, from an independent foreign company, the rights to use and to register a foreign company's trademark for use in the United States.[11]

If the foreign company's manufactured goods have already earned a reputation for quality, then the right to use that trademark in the sale of those goods could be very valuable.[12] The value of these rights acquired by the domestic company, would be sharply reduced if the foreign manufacturer of the trademarked goods could import the trademarked goods into the United States and distribute them, despite having sold the trademark to the domestic company.[13] Under these circumstances, where both the foreign and the domestic companies are importing goods with the same trademark into the United States, a grey market may develop, generating intra-brand competition which endangers the U.S. trademark holder's investment in the trademark.[14]

The grey market safeguard of section 1526 is best understood in the context of, *A. Bourjois & Co. v. Katzel*, a judicial opinion that led the U.S. Congress to enact section 1526's rules protecting domestic companies from

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7. 19 U.S.C. § 1526(a) (2000). The full text of section 1526(a) is as follows:
(a) Importation Prohibited —
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 trade-mark owned by a citizen of, or by a corporation or association created or organized with, the United States, and registered in the Patent Office (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 trade-mark 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 trade-mark is produced at the time of making entry.
8. *See* K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 286-87 (1988).
9. *Id.* at 285.
10. *Id.* at 286.
11. *Id.* at 286.
12. *Id.*
13. *K Mart*, 486 U.S. at 286.
14. *Id.*.

grey market competition.[15] In *Katzel*, the plaintiff, a U.S. corporation, paid a premium to a French producer of face powder in exchange for the goodwill[16] of the French company and for the rights to its U.S. trademark.[17] Plaintiff then registered the newly purchased trademark under its own name, and continued to import the powder from France, selling it domestically.[18] Defendant imported the same face powder into the United States from France, and sold the powder under a virtually identical mark.[19] As a result of defendant's actions, plaintiff filed a complaint for trademark infringement.[20]

Despite the inequity of the competition, where defendant continued to import the trademarked goods after selling the trademark to plaintiff, the Court of Appeals for the Second Circuit declined to enjoin defendant from importing and selling the trademarked powder in the United States.[21] In finding for defendant, the *Katzel* court held the importing of goods bearing a trademark registered in the United States did not constitute a trademark violation so long as the trademark accurately identified the source of the goods.[22] The *Katzel* court reasoned that trademarks do not confer a monopoly on the holder over intra-brand competition, but merely protect the public from deception by indicating the source of the marked goods.[23]

In response to the *Katzel* decision, Congress passed section 1526 of the Tariff Act of 1922.[24] Section 1526 was later reenacted without change in 1930.[25] The provision prohibits importing "into the United States any merchandise of foreign manufacture if such merchandise . . . bears a trademark owned by a person or corporation domiciled in the United States."[26]

Although the plain language of the statute grants a U.S. trademark holder the power to prohibit any party from importing foreign merchandise

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15. A. Bourjois & Co., v. Katzel 275 F. 539 (CA2 1921), *rev'd*, 260 U.S. 689 (1923).

16. "Goodwill may be defined as the favorable consideration shown by the purchasing public to goods known to emanate from a particular source." White Tower Systems, Inc. v. White Castle System of Eating Houses Corp., 90 F.2d 67, 69 (6th Cir. 1937).

17. *Katzel*, 275 F. at 540.

18. *Id.*

19. *Id.* The difference between the plaintiff's mark and the defendant's mark was insubstantial. Plaintiff sold the powder under the mark, "Poudre Java," while defendant sold the powder under the mark "Pondre de Riz de Java."

20. *Id.*

21. *Id.* at 543.

22. *Katzel*, 275 F. at 543.

23. *Id.*

24. *See* K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 287 (1988).

25. *Id.*

26. *Id.* at 288; *see* 19 U.S.C. § 1526(a) (2000).

bearing its trademark, such grey market protection has not applied equally across the board to all goods imported with a U.S. trademark.[27] The Customs Service restricted the scope of section 1526's ban on grey market goods when Customs established regulations for implementing section 1526.[28]

The regulations implementing section 1526 created a "common control"[29] exception to the general ban of section 1526.[30] The common control exception permits the actual trademark holder or by an affiliate of the trademark holder operating under the common control of the holder to import grey market goods manufactured abroad.[31] Trademark holders in the United States, concerned that the common control exception permitted the entry of grey market goods into U.S. markets, tested the validity of the regulation in court.[32]

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27. *K Mart*, 486 U.S. at 288.

28. *Id.*

29. *Id.* at 288 n.2; *see* 19 C.F.R. § 133.21 (1987). The Customs Service regulation in effect when *K Mart* was decided was entitled "Restrictions on Importations of Articles Bearing Recorded Trademarks and Trade Names," and provided in relevant part:

> (a) Copying or Simulating Marks or Names — Articles of foreign or domestic manufacture bearing a mark or name copying or simulating a recorded trademark or trade name shall be denied entry and are subject to forfeiture as prohibited importations. A "copying or simulating" mark or name is an actual counterfeit of the recorded mark or name or is one which so resembles it as to be likely to cause the public to associate the copying or simulating mark with the recorded mark or name.
>
> (b) Identical Trademark — Foreign-made articles bearing a trademark identical with one owned and recorded by a citizen of the United States or a corporation or association created or organized within the United States are subject to seizure and forfeiture as prohibited importations.
>
> (c) Restrictions not Applicable — The restrictions set forth in paragraphs (a) and (b) of this section do not apply to imported articles when:
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> (1) Both the foreign and the U.S. trademark or trade name are owned by the same person or business entity;
>
> (2) The foreign and domestic trademark or trade name owners are a parent and subsidiary companies or are otherwise subject to common ownership or control.
>
> (6) The recordant gives written consent to an importation of articles otherwise subject to the restrictions set forth in paragraphs (a) and (b) of this section, and such consent is furnished to appropriate Customs officials.

Id.

30. *See supra* text accompanying note 7.

31. *See K Mart*, 486 U.S. at 289; *see also* 19 C.F.R. § 133.21 (1987).

32. *See K Mart*, 486 U.S. at 290.

The issue was ultimately heard by the U.S. Supreme Court in *K Mart Corp. v. Cartier, Inc.*[33] In *K Mart*, the Court found that section 1526 was ambiguous,[34] and permitted Customs to promulgate regulations to interpret the section.[35] Determining that the common control exception was consistent with section 1526, the *K Mart* Court held that the exception was a permissible clarification resolving ambiguous language in the Tariff Act.[36]

The principal ambiguity in section 1526 lay in determining ownership of a trademark.[37] Section 1526 is protectionist in measure[38] and applies to trademarks "owned by" U.S. citizens or companies.[39] In the context of the statute, "owned by" is ambiguous because it is difficult to determine if a foreign parent company is the true owner of a trademark registered in the United States by its domestic subsidiary.[40]

The common control exception[41] to the import ban on grey market goods operates under the premise; if the domestic company and the foreign company are under common control, then the domestic company can

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33. *See supra* text accompanying note 7.

34. *K Mart*, 486 U.S. at 292 (The *K Mart* Court stated that in "determining whether a challenged regulation is valid, a reviewing court must first determine if the regulation is consistent with the language of the statute." A finding of ambiguity in the statute is thus a threshold consideration that must be found to determine if an agency is empowered to create rules applying the statute. Otherwise, the agency must follow the clear intent of Congress.).

35. *Id.*

36. *Id.* at 292.

37. *Id.*

38. *Id.* at 297. Justice Brennan, in a fiery concurrence opinion examining the legislative history behind section 1526, declared:

> The most blatant hint that Congress did not intend to extend § 1526's protection to affiliates of foreign manufacturers is the provision's protectionist, almost jingoist, flavor. Its structure bespeaks an intent, characteristic of the times, to protect only domestic interests. A foreign manufacturer that imports its trademarked products into the United States cannot invoke § 1526 to prevent third parties from competing in the domestic market by buying the trademarked goods abroad and importing them here. . . . The barriers that Congress erected seem calculated to serve no purpose other than to reserve exclusively to domestic, not foreign, interest the extraordinary protection that § 1526 provides. But they are fragile barriers indeed if a foreign manufacturer might bypass them by the simple device of incorporating a shell domestic subsidiary and transferring to it a single asset — the United States trademark.

39. *K Mart*, 486 U.S. at 287; *see also* 19 U.S.C. § 1526 (2000).

40. *K Mart*, 486 U.S. at 292.

41. *See* 19 C.F.R. § 133.23(d)(1) (1987).

readily stop the foreign company from importing the common good.[42] Determining what constitutes common control is difficult in the tangle of modern business associations.[43] However, case law provides some signposts guiding this inquiry.[44]

The *Vittoria* court unraveled the business relationship between VNA and Vittoria Italy.[45] EAI contended that *inter alia*, Vittoria Italy was more than just a mere manufacturer of the Vittoria-branded tires sold by VNA.[46] EAI alleged that Vittoria Italy also contributed to the marketing budget of VNA for the Vittoria-branded tires, coordinated advertising plans, and influenced the lines of products that VNA sold.[47]

The *Vittoria* court found that the existence of a close and profitable business relationship or evidence that the American company is part of a larger, closely knit foreign structure is insufficient to establish common control.[48] The facts advanced by defendant could exist in any manufacturer

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42. *See* Vittoria N. Am., L.L.C. v. Euro-Asia Imports, Inc., 278 F.3d 1076, 1085 (10th Cir. 2001).

43. *See* Vincent N. Palladino, *Gray Market Goods: The United States Trademark Owners' View*, 79 TRADEMARK REP. 158, 192 (1989).

44. *See* Vittoria N. Am., L.L.C. v. Euro-Asia Imports, Inc., No. CIV-99-1357-A, 2000 U.S. Dist. Lexis 21683 (W.D. Okla. July 12, 2000).

45. *Id.* at 11-12.

46. *Id.*

47. *See Vittoria*, 278 F.3d at 1085. On appeal, EAI asserted that genuine issues of material fact regarding the common control between Vittoria Italy and VNA existed with respect to the following allegations:

> (1) VNA and Vittoria Italy work in concert to design, develop and distribute Vittoria products;
> (2) VNA and Vittoria Italy make joint decisions as to "present and future product ranges";
> (3) Vittoria Italy sells Vittoria-branded products directly to original equipment manufacturers in the United States;
> (4) Vittoria Italy pays a significant percentage of VNA's advertising budget and exercises some measure of control over VNA's marketing of Vittoria products;
> (5) Vittoria Italy determines which product lines VNA is allowed to market in the United States;
> (6) Vittoria Italy reimburses VNA for nearly all of its liability for warranty claims on Vittoria products;
> (7) Vittoria Italy's catalog lists VNA as its "U.S. distributor"; and
> (8) the president and CEO of Vittoria Italy, Rudie Campagne, makes decisions about employees of VNA as well as a sister company of VNA called XLM.

Id. at 1084-85. The instant court dispatched all of these allegations in two paragraphs as mere evidence of a close business relationship, not of common control. *Id.*

48. *Vittoria*, 2000 U.S. Dist. Lexis 21683, at 13.

and distributor relationship.[49] Similarly, the *Vittoria* court found that the companies share a common goal, that being a profitable relationship, which is promoted by working together.[50]

The *Vittoria* court also found that, although the companies may agree with each other about which products to carry, this agreement does not mean that either company made the decision for the other.[51] Finding no genuine issue of material fact regarding the common control exception, the *Vittoria* court granted a motion for summary judgment to VNA and enjoined EAI from importing anymore Vittoria products.[52] EAI appealed, challenging the grant of summary judgment by the district court arguing that the evidence was insufficient for summary judgment.[53]

The Tenth Circuit U.S. Court of Appeals took the instant case on appeal.[54] Examining, *inter alia*, the common control exception,[55] the *Vittoria* court of appeals affirmed the summary judgment.[56] The instant court held that the close and profitable relationship pointed to by EAI indicated no evidence of common control between VNA and Vittoria Italy.[57]

In deciding the instant case, the court of appeals examined the business relationship between Vittoria Italy and VNA for common control.[58] Initially

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49. *Id.*

50. *See id.* The court of appeal found that the assignment agreement between Vittoria Italy and VNA called for cooperative planning. *Vittoria*, 278 F.3d at 1085.

51. *See Vittoria*, 2000 U.S. App. Lexis 21683, at 13.

52. *Id.* at 18.

53. *See Vittoria*, 278 F.3d at 1079.

54. *Id.*

55. *See* 19 C.F.R. § 133.23(d)(1) (1987) (modifying the common control exception regulation analyzed in *K Mart Corp. v. Cartier, Inc.*, 486 U.S. 281 (1988)). Section 133.23(d)(1) reads, in relevant part:

> Gray market goods subject to the restrictions of this section shall be detained for 30 days from the date on which the goods are presented for Customs examination, to permit the importer to establish that any of the following exceptions . . . are applicable:
> (1) The trademark or trade name was applied under the authority of a . . . trade name owner who is the same as the U.S. owner, a parent or subsidiary of the U.S. owner, or a party otherwise subject to common ownership or control with the U.S. owner . . . .

56. *Vittoria*, 278 F.3d at 1079.

57. *Id.* at 1085.

58. *See id.*

focusing on the definition of common control[59] provided by the regulations, the instant court noted that the regulatory language contemplated the kind of control that a parent corporation would exercise over a subsidiary.[60] Following in the footsteps of the district court, the instant court found that the stipulated facts of EAI alleging common control merely indicated a close business relationship between the companies, rather than indicating common control.[61]

According to the *Vittoria* court, a close and profitable business relationship falls short of establishing common control as defined in the regulations.[62] For example, the instant court pointed out that although Vittoria Italy may help fund the advertising budget of VNA, such help is not evidence of control.[63] Vittoria Italy has no legal control over how those funds are spent.[64]

Additionally, in the instant case the *Vittoria* court examined the policy considerations underlying section 1526.[65] The *Vittoria* court determined that the U.S. Congress intended to protect domestic firms from grey markets.[66] The *Vittoria* court found that the attempt by EAI to extend the common control exception to companies that merely work closely together did not advance any policy considerations of section 1526.[67]

The first of these policy considerations recognized by the instant court was that U.S. companies acquiring trademarks from foreign firms have significantly more investment-backed expectations at stake than similarly situated subsidiaries of foreign firms.[68] Second, foreign firms covered by the common control exception can protect their U.S. marketing efforts by restricting the sale of goods to customers who will export them.[69] In contrast, a U.S. trademark holder working cooperatively with a foreign manufacturer cannot control to whom the foreign manufacturer sells its products.[70]

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59. 19 C.F.R. § 133.2 (1987) (defining common control as "effective control in policy and operations and is not necessarily synonymous with common ownership.").

60. *See Vittoria*, 278 F.3d at 1084.

61. *Id.* at 1085.

62. *Id.*

63. *Id.*

64. *Id.*

65. *See Vittoria*, 278 F.3d at 1085-86.

66. *Id.*

67. *Id.*

68. *Id.* at 1086.

69. *Id.*

70. *Vittoria*, 278 F.3d at 1086.

It is clear that product control is integral to trademark protection.[71] Trademarks have developed well beyond the rationale espoused in *Katzel*, that of a mere source identifier.[72] As the instant case illustrates, trademarks represent the reputation and image of the brands they signify. They are marketing tools. The more extensive the advertising and marketing, the greater the value of the mark. Thus, the trademarks are indistinguishable from the goodwill and public confidence in products which particular trademarks invoke.[73]

Under the common control exception, this goodwill and public confidence could easily be broken. Ideally, if a foreign manufacturer and a domestic importer were under common control, it would only be a matter of executive decision to curb importation of grey market goods.[74] Yet in the increasingly complex labyrinth of corporate structures, the instant court's common control of corporate ownership's facades might not represent economic reality.[75]

As one commentator has questioned, when a domestic subsidiary owning a U.S. trademark outstrips its foreign parent in size, would the subsidiary not be tanamount to a domestic firm that had purchased the trademark?[76] As the domestic subsidiary grows and pays for expensive advertising and marketing to distinguish its mark, the parent abroad could still create grey markets domestically by selling to entities known to export.[77] Under the common control exception analyzed by the instant

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71. *See* Palladino, *supra* note 43, at 191 (stating that the U.S. Supreme Court in *K Mart* "largely ignored . . . the broader issues raised by a multibillion dollar marketing practice, such as the value of domestic good will that a trademark may symbolize; the effect on that good will of gray market importation, including whether or not gray market imports unfairly trade on domestic good will . . .").

72. A. Bourjois & Co. v. Katzel, 275 F. 539, 544 (2d Cir. 1921).

73. *See Vittoria*, 278 F.3d at 1082.

> The *Vittoria* Court reaffirmed the proposition that "[a] trademark symbolizes the public's confidence or 'goodwill' in a particular product. However, it is no more than that, and is insignificant if separated from that confidence. 'Therefore, a trademark is not the subject of property except in connection with an existing business.'"

Id. (quoting Premier Dental Products Co. v. Darby Dental Supply Co., 794 F.2d. 850, 853 (3d Cir. 1986) and United Drug Co. v. Theodore Recantus Co., 248 U.S. 90, 97 (1918)).

74. *See Vittoria*, 278 F.3d at 1085-86.

75. *See* Palladino, *supra* note 43, at 192.

76. *Id.*

77. *See id.*

court,[78] the subsidiary has no recourse to prevent the grey market goods from diluting its domestic market.[79] This, in turn, may adversely impact the domestic subsidiary's investment. The subsidiaries investment sinks.

The sinking of the investment can occur in a variety of ways not taken into account by the instant court.[80] For instance, if the quality of a grey market good is shoddy, then the reputation of the mark diminishes.[81] Although a grey market good may be genuine, domestic subsidiaries interested in maintaining the goodwill and reputation behind the mark might have implemented quality control devices not found with their foreign counterparts.[82]

Thus, grey market goods not subject to these quality control devices pressure the domestic trademark holder to service and warranty the grey market goods in order to protect their product's goodwill and thereby protect the trademark holder's investment in the mark.[83] Grey marketers have little incentive to worry about the harm done to the product's reputation because only the trademark holder bears that harm.[84] In instances such as these, where the trademark holder has substantially invested in the goodwill behind its mark, it is inequitable to let grey marketers profit off of a situation which they had no hand in creating.[85]

One of the principle policy reasons behind enacting section 1526 was to protect domestic interests.[86] Although the *K Mart* Court deemed the common control exception a reasonable administrative interpretation of section 1526,[87] this exception hinders the protection of domestic firms' investments in some trademarks by allowing the possibility of grey marketer freeloading. Such grey marketer freeloading endangers U.S. companies. As a conduit of protectionist social policy, the U.S. Congress implemented section 1526 to prevent such a result. Even where companies are under common control, a U.S. trademark holder paying to establish goodwill may still be injured by the related manufacturer that exports goods to the mark holder's domestic market, without the domestic mark holder's consent.[88]

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78. *Vittoria*, 278 F.3d at 1085-86.
79. *Id.*; *see also* 19 C.F.R. § 133.23(d)(1) (1987).
80. *See* Palladino, *supra* note 43, at 194.
81. *Id.*
82. *See id.* at 195.
83. *Id.* at 194-95.
84. *Id* at 196.
85. *See* Palladino, *supra* note 43, at 196.
86. *See* K Mart Corp. v. Cartier, Inc., 486 U.S. 281, 297 (1988).
87. *See id.* at 292.
88. *See* Palladino, *supra* note 43, at 203-04.

Thus, the common control exception unreasonably impinges upon domestic rights of trademark holders and subverts domestic interests.