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I. INTRODUCTION

When the European Court of Justice ("ECJ") issued its final decision in the case of Levi Strauss & Co. v. Tesco Stores Ltd.1 in November 2001, affirming Levi Strauss' right to keep cut-price imported Levis out of the European Union ("E.U.") , the general public was outraged at the perceived blow to consumer rights. The ECJ's decision to allow Levi Strauss to prohibit "gray market" imports of its jeans from the United States for resale in the United Kingdom at prices much cheaper than Levi Strauss' own U.K. prices was characterized as protecting "big business" at the expense of consumers.2 While the decision undoubtedly was a "strong win for brand own-
ers," the Court was correct in ruling for Levi Strauss, given the relevant E.U. statutes and case law regarding E.U. trademark protection.

This article examines current E.U. law on the sale of "gray market goods," that is, trademarked goods imported without the trademark owner's consent, and explains the *Levi Strauss* decision and its predecessor cases, which center on the E.U.'s policy of "regional exhaustion" of trademarks. The article then looks at the alternative approaches of "international exhaustion" of trademarks and the American "hybrid" exhaustion system, which contains an important and highly effective exception that allows many gray market imports and results in cheaper consumer prices in the United States. In conclusion, the article examines the advantages and disadvantages of the European Union changing its current laws in this area, and recommends that the European Union eschew calls for adoption of an international exhaustion system and instead adopt the American "hybrid" system that includes the "common control exception" as its centerpiece.

II. TRADEMARK EXHAUSTION AND THE E.U. SYSTEM

A. The Principle of Exhaustion

A trademark is a legal device with two purposes. First, it promotes innovation and creativity by rewarding the creator of a trademarked good with legal protections against its product being marketed or sold by unauthorized parties. Second, because only the trademark owner (and its licensees) may use the trademark, the appearance of a trademark, such as a brand name on a product, assures customers of the genuineness of the product; consumers can rely on a trademark to know that they are getting the same product they previously bought, saw advertised, or had recommended to them, with the same properties and qualities as other products with the same trademark.

Virtually all countries provide for legal protection of trademarks, but they do so in varying degrees. While basic trademark law in all countries protects the trademark owner against a counterfeit copy of its trademarked product, nations differ in the level of protection given to a trademark owner when a third party imports a genuine trademarked product into a country and sells it in competition with the trademark owner.

Most countries follow some version of the "exhaustion principle;"4

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4 The only multilateral and/or plurilateral agreement of the World Trade Organization ("WTO") that explicitly addresses the exhaustion issue is Article 6 of the Agreement on
which provides that once a trademark owner has sold his trademarked product in a specific country, she has “exhausted” his trademark protection and can no longer prevent other parties from re-selling his trademarked product either within that country (“national” or “domestic exhaustion”), or within a group of countries (“regional exhaustion”), or anywhere in the world (“international exhaustion”). The premise of exhaustion laws is that a trademark owner is protected by her trademark rights until she makes the “first sale” of her trademarked item, after which she should no longer be able to control the item or its sale, and the new owner should be able to re-sell it to whomever he chooses, wherever he chooses (barring a provision to the contrary in the sales contract). The “first sale” principle therefore promotes free alienation of goods and the free market system, which are generally considered favorable goals. The more one believes that worldwide “free trade” is desirable, the more one would lean toward an international exhaustion system, with its lack of barriers for the movement and sale of goods between countries.

When the buyer of trademarked goods exports them to another country and sells them in competition with the trademark owner, the items are called “gray market goods” (or sometimes “parallel imports”). Gray market goods are controversial because they are usually cheaper than the goods.

Trade Related Intellectual Property Rights, which states: “[N]othing in this Agreement shall be used to address the issue of the exhaustion of intellectual property rights.” Agreement on Trade Related Aspects of Intellectual Property Rights, Marrakesh Agreement Establishing the World Trade Organization, Annex 1C, Legal Instruments, Apr. 15, 1994, Uruguay [hereinafter TRIPS Agreement]. This is widely interpreted as an “agreement to disagree,” allowing WTO members the freedom to choose either national, regional, or international trademark exhaustion. This stance was confirmed by the Doha WTO Ministerial Conference on November 20, 2001: “The effect of the provisions in the TRIPS Agreement that are relevant to the exhaustion of intellectual property rights is to leave each member free to establish its own regime for such exhaustion without challenge....” Declaration on the TRIPS Agreement and Public Health, WT/MIN(01)/DEC/2 (Nov. 20, 2001), available at http://www.wto.org/english/tratop_e/trip_e/wha_e/wha1_e/whadocuments_e.htm.

More specifically, national exhaustion provides that a trademark owner cannot stop re-sales in the country where she sold that specific good, but retains the right to prohibit sales of goods that she sold outside the country which have been imported into the country. Regional exhaustion laws provide that the trademark owner cannot stop re-sales anywhere within a group of countries in which she has sold the product (e.g., the European Union) but may, within that region, stop sales of products she originally sold outside the region. In a system of international exhaustion, the trademark owner’s sale of the product anywhere in the world allows anyone to resell the product anywhere worldwide without the trademark owner’s consent.

In some countries, sales contracts may limit the buyer’s use or re-sale of the item. However, this occurs in a very small minority of consumer transactions because such sales mostly take place in stores without a contract of any kind being signed by the buyer. See infra Sec. IV.D. for further discussion of sales contract restrictions.

Whereas “black market” goods are counterfeit, gray market goods are genuine trademarked products that have been lawfully sold by the trademark owner abroad and lawfully purchased by another party.
sold by the trademark owner (for reasons discussed herein), thereby presenting the trademark owner with unexpected (and unauthorized) in- 
brand competition and lost sales of its own products. Thus, gray market goods are loved by consumers but loathed by trademark holders, and this inherent conflict must be considered by governments when deciding which exhaustion system to adopt. As the world moves toward the goal of global free trade, these decisions balancing the interests of consumers with the interests of business are becoming increasingly important.

B. The E.U. System of Regional Exhaustion

1. Trademark Directive 89/104

All member states of the European Union were required to adopt national laws based on E.U. Directive 89/104 (the “Trademark Directive”), which provides for regional exhaustion of trademarks. Article 5 of the Trademark Directive, entitled “Rights conferred by a trade mark,” protects a trademark owner from third parties using his trademark without his consent before his first sale of the trademarked product within the European Union:

1. The registered trade mark shall confer on the proprietor exclusive rights therein. The proprietor shall be entitled to prevent all third parties not having his consent from using in the course of trade:

(a) any sign which is identical with the trade mark in relation to goods or services which are identical with those for which the trade mark is registered;

3. The following, inter alia, may be prohibited [under subparagraph 1]:

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8 Council Directive 89/1094, 1989 O.J. (L 040) 1, amended by 392D0010 1992 O.J. (L 006) 35 [hereinafter Trademark Directive]. A Directive is a statute approved by the European Parliament which then must be passed by all E.U. member states, according to the E.U. founding agreement. Thus, in the subject areas in which Directives exist, all member states should have consistent, if not identical, laws. Even with national laws based on the same Directive, however, the interpretations of such laws by member states’ national courts sometimes differ; in such a case, the highest court of any member state may appeal to the European Court of Justice for a final interpretation that will apply in all member states. This is exactly what happened in the Levi Strauss case.

9 All E.U. Member States have incorporated the Trademark Directive into their national laws. Furthermore, in accordance with the European Economic Area (“EEA”) Agreement (Article 65(2) and Annex XVII, point 4), the Trademark Directive’s application was expanded to the entire EEA, which consists of all E.U. members plus Norway, Iceland and Liechtenstein. The statute at issue in Levi Strauss was the United Kingdom’s enactment of the Directive, entitled the “Trade Marks Act of 1994,” effective Oct. 31, 1994.
... (b) offering the goods, or putting them on the market or stocking them for these purposes under that sign, or offering or supplying services thereunder;

(c) importing or exporting the goods under the sign;

(d) using the sign on business papers and in advertising....

However, Article 7 of the Trademark Directive, entitled “Exhaustion of the rights conferred by a trade mark,” provides that once a trademark owner sells (or gives another permission to sell) his trademarked good anywhere in the European Union, he may not prevent the re-selling of the good by someone else within the European Union:

1. The trade mark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the [European] Community under that trade mark by the proprietor or with his consent.

Since the Directive mandates only “regional exhaustion” (i.e., intra-E.U.), the trademark owner still can prevent the sale in the European Union of goods that he originally sold outside the European Union. For example, where a trademark owner has sold a product in the United States or another non-European Union nation, and the buyer exports the product to a E.U. country, the trademark owner may prohibit the buyer from re-selling the product in that country. The parameters of this regional exhaustion system have been thoroughly interpreted by the European Court of Justice, as will be discussed next.

2. Legislative History of Directive 89/104 and Clarifying Case Law

Interestingly, the legislative history of the European Union’s Trademark Directive clearly demonstrates that in the original proposal for the Directive, international, not just regional, exhaustion was desired. If adopted, an international exhaustion regime would have mandated that goods sold anywhere in the world by an E.U. trademark owner could be imported and sold in the European Union by anyone else, without the trademark owner’s permission. However, as detailed below, the E.U. governing bodies decided after much study and consideration that regional exhaustion served the needs of the European Union better than the more liberal international exhaustion system.

The Trademark Directive was first proposed by the European Commission on November 25, 1980 to “eliminate the obstacles to free movement of

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10 Trademark Directive, supra note 8, art. 5.
11 Id. art. 7.
goods, and the distortion of competition in the common market, that result from disparities in the Member States’ trademark laws,” by making all such laws consistent. The Commission’s Draft Article 6 clearly intended to adopt international exhaustion, stating without geographical limits that “[t]he trade mark shall not entitle the proprietor thereof to prohibit its use in relation to goods which have been put on the market under that trade mark by the proprietor or with his consent.” The original commentary to Draft Article 6 further specified that “[t]he place where the marked product is put on the market is not important... The [exhaustion] principle ... applies regardless of whether the product bearing the Community trademark was put on the market within or outside the Community.”

In late 1981, the European Union’s Economic and Social Committee reviewed and commented on the Draft Trademark Directive, proposing that Draft Article 6 apply only where the trademarked good has been sold “in the European Community” because the Committee believed that an international exhaustion system “would lead to undesirable commercial consequences. [Specifically,] [i]n so far as third countries do not acknowledge the principle of international exhaustion the [original] proposal would result in discrimination [against] industry in the Community.” In other words, the Committee thought that the adoption of international exhaustion would put E.U. industries at a disadvantage vis-à-vis foreign companies because companies from countries that did not follow international exhaustion could purchase E.U.-trademarked goods anywhere in the world and resell them in the European Union in competition with the trademark owners, but would be protected from such competition in their own countries from E.U. members. This change in the Draft Trademark Directive was (of course) supported by European corporations, as well as all E.U. members except Germany.

13 Id. art. 6.
14 Commentary to Article 6, referencing commentary in Explanatory Memorandum to Article 11 of the Council Regulation on a Community Trade Mark 40/94, COM(80) 635 final at 34. The draft provided, however, for an exception “where there are legitimate grounds for opposing importation into the Community of goods put on the market outside it.” Draft Trademark Directive, supra note 12, art. 6(2)(a).
15 See Opinion of the Economic and Social Committee, 1981 O.J. (C 310) 22.
After review and suggestions by the European Parliament,\textsuperscript{18} in 1985 the Commission published an Amended Proposed Trademark Directive that officially adopted the Committee’s proposal of regional trademark exhaustion rather than international.\textsuperscript{19} The final adopted language read: “The trademark shall not entitle the proprietor thereof to prohibit its use in relation to goods which have been put on the market in the Community under that trademark by the proprietor or with his consent.”\textsuperscript{20} The European Union’s decision to adopt a regional exhaustion regime was both a practical and philosophical compromise between the principle of totally free movement of goods on one hand, and on the other hand, protecting E.U. businesses and trademark holders from imports from outside the European Union. The Commission found inherent in the international exhaustion regime an unacceptable disparity of opportunity between E.U. merchants in non-E.U. countries and non-E.U. merchants in E.U. countries.

After the adoption of the Trademark Directive in 1989, E.U. member states debated whether they could individually extend the Directive’s regional exhaustion regime by adopting international exhaustion in their own national laws. The question was whether the regional exhaustion mandated by the Directive was a “minimum” which left member states free to adopt other, more liberal alternatives (i.e., international exhaustion systems). This question was definitively answered in the negative in Silhouette Int’l Schmied GmbH & Co. KG v. Hartlauer Handelsgesellschaft mbH,\textsuperscript{21} in which the ECJ held that the Trademark Directive requires all member states to adopt nothing more or less than regional exhaustion because the primary purpose of the Trademark Directive was to harmonize all member states’ trademark exhaustion laws. Allowing some members to practice international exhaustion while others have only regional exhaustion would undermine the internal E.U. market by raising barriers to the free movement of goods among the members.\textsuperscript{22}

\textsuperscript{18} The European Parliament accepted the Economic and Social Committee comments in 1983 and requested that the European Commission adopt the suggested amendments. 1983 O.J. (C 307) 66-68.
\textsuperscript{19} The Commentary to Amended Draft Article 6(1) stated: “In line with the proposals made by the Economic and Social Committee and Parliament, the Commission has decided not to introduce international exhaustion....” Commentary to Amended Draft, (COM 85) 351 final at 13.
\textsuperscript{21} Case C-355/96, 1998 E.C.R. I-04799.
\textsuperscript{22} Since the Silhouette case, it has been accepted that any extension of exhaustion outside of the European Union can be done only through an amendment to the Trademark Directive or the conclusion of international agreements providing for wider exhaustion between the European Union (as a whole) and another country(ies).
After *Silhouette*, the major questions regarding interpretation of the Trademark Directive centered on whether a trademark owner could *implicitly* consent to another's importation and selling of its goods in the European Union, or whether that consent must be explicit.\(^\text{23}\) Part of this question was answered in July 1999 in *Sebago Inc. v. Ancienne Maison Dubois et Fils SA*,\(^\text{24}\) in which the ECJ examined whether, by selling a particular batch of imported goods within the European Union, a trademark owner impliedly consented to the sale within the European Union of other imported batches of similar or identical goods which it had sold elsewhere. The ECJ decided in the negative, holding that when a trademark owner sells (or consents to the sale of) a particular batch of its trademarked products in the European Union, she has not exhausted her right under Article 7(1) to prohibit sales in the European Union of identical goods (i.e., the same *type* or *style* of goods) apart from *that specific, defined batch* to whose sale she consented. The ECJ stated:

...[T]he rights conferred by the trade mark are exhausted only in respect of the individual items of the product which have been put on the market with the proprietor's consent in the territory there defined. The proprietor may continue to prohibit the use of the mark in pursuance of the right conferred on him by the [Trademark] Directive in regard to individual items of that product which have been put on the market in that territory without his consent.\(^\text{25}\)

Thus, the concept of regional exhaustion in the European Union means that a third party can only re-sell the specific items within the European Union that the trademark holder has already sold there, and the fact that the holder does not expressly forbid the export of its items to the European Union from non-E.U. countries does not constitute implied consent to the third party's sale of such items inside the European Union. However, the *Sebago* court did not address whether other circumstances of implied consent could be sufficient to allow third party sales in the European Union of items previously sold outside the European Union. This was the central issue in *Levi Strauss v. Tesco*.

### 3. *Levi Strauss v. Tesco*

Levi Strauss (the American parent company) and Levi Strauss U.K. (the British holder of the U.K. trademark license for Levi Strauss) alleged

\(^{23}\) Recall that Article 7(1) of the Trademark Directive, *supra* note 8, provides that "*[t]he trade mark shall not entitle the proprietor to prohibit its use in relation to goods which have been put on the market in the Community under that trade mark by the proprietor or with his consent."* (emphasis added). The remaining issue was how overt this consent must be.

\(^{24}\) Case C-173/98, 1999 E.C.R. I-04103.

\(^{25}\) Id., ¶ 19.
trademark infringement against Tesco and Costco, two U.K.-based hyper-markets which sell a huge variety of goods, ranging from groceries to clothing to electronics. Levi Strauss had refused to sell its blue jeans to Tesco or Costco, preferring to sell only to approved dealers such as Levis name-brand shops and upscale department stores in the European Union.\textsuperscript{26} Nevertheless, Tesco and Costco bought Levis jeans from retailers and wholesalers who had purchased them from accumulators\textsuperscript{27} in the United States, Mexico, and Canada, then imported the jeans into the United Kingdom and sold them at substantially lower prices than Levi Strauss-approved retailers.\textsuperscript{28} Importantly, the jeans sold by Tesco and Costco were identical to those sold by Levi Strauss-approved retailers in the United Kingdom and the European Union.

Tesco and Costco asserted that while Levi Strauss had not sold these particular batches of jeans in the European Union, and had not expressly consented to Tesco and Costco importing and selling the jeans in the European Union, \textit{Sebago} was not applicable because Levi Strauss had \textit{impliedly} consented to such import and sale by not taking stricter measures to prevent it, such as labeling the jeans as “not for sale outside the United States/Mexico/Canada” or requiring buyers in the United States, Mexico and Canada to include in their sales contracts with third parties a restriction on resale and/or export of the jeans.\textsuperscript{29} Tesco and Costco argued that Levi Strauss should be required to undertake such preventive measures if it objected to its products being imported into the European Union.\textsuperscript{30}

Levi Strauss (and the French Government in its brief to the ECJ) asserted that in order for third parties to import and sell trademarked goods in the European Union, the Trademark Directive required that the trademark

\textsuperscript{26} During the pendency of the case, Levi Strauss explained to the press that it refused to sell to Tesco and Costco because it wanted to sell its products in the manner that would best serve its customers, namely, through selected outlets which were “trained” in fitting and selling Levis and providing excellent customer service. Levis also claimed that its jeans would lose their cachet and exclusivity if they were sold in grocery stores like Tesco. Levi Strauss spokeswoman Paola Brandi, speaking to the press after the decision, “declined to say why Tesco did not live up to Levis standards, but suggested that the sight of Levis jeans piled on shelves next to breakfast cereal and dog food might have been part of the reason.” Stanley, \textit{supra} note 2; \textit{see also} Osborn, \textit{supra} note 2 (quoting Levi Strauss as arguing that “its premium brand reputation was at stake if any supermarket could sell its products at ‘bargain-basement prices’”).

\textsuperscript{27} An accumulator is an individual or company who buys goods in small amounts from many sources and then sells the accumulated large quantity.

\textsuperscript{28} At the time of the decision, a pair of Levis “red tab 501” jeans sold for $38.50 at Levis retailers in the United States, but at the equivalent of $59.80 at approved retailers in France, $65.55 in the United Kingdom, and $67.63 in Sweden. \textit{See} Stanley, \textit{supra} note 2. Tesco sold the jeans in the United Kingdom for just under $40. \textit{See} Cowell, \textit{supra} note 3.

\textsuperscript{29} Levi Strauss v. Tesco, \textit{supra} note 1, ¶ 27 (emphasis added).

\textsuperscript{30} \textit{Id.} ¶¶ 49-50, 52.
owner's consent be express and clearly evidence an intention to renounce trademark rights. Further, Levi Strauss argued, even if the burden was on it to take preventive steps such as Costco and Tesco suggested, it had done so by prohibiting its buyers in the United States, Mexico and Canada from selling to anyone but end-users of the jeans, and limiting sales to six pairs of jeans per customer.\[31\]

Among the several questions posed to the ECJ were:

(1) Where trademarked goods have been placed on the market in a non-E.U. country by the trademark owner (or with his consent) and have been imported into or sold in the European Union by a third party, does the [Trademark] Directive entitle the trademark owner to prohibit such importation or sale unless he has expressly and explicitly consented to it, or may such consent be implied?

(2) If the answer to Question 1 is that consent may be implied, can consent be implied from the fact that the goods have been sold by the trademark owner or on his behalf without contractual restrictions prohibiting resale within the European Union binding the first and all subsequent purchasers?

(3) Where trademarked goods have been placed on the market in a non-E.U. country by the trademark owner:

(a) to what extent is it relevant whether or not:

(i) the trademark owner consented to the placing of those goods on the E.U. market without any marking or notice on the goods indicating that they may not be sold in the European Union; and/or

(ii) the person placing the goods on the E.U. market does so with the knowledge that the trademark owner objects to those goods being sold in the European Union; and/or

(iii) the person placing the goods on the market does so with the knowledge that the trademark owner objects to those goods being sold in the European Union by anyone otherwise than an authorized retailer; and/or

(iv) the goods have been purchased from authorized retailers in a non-E.U. country who have been told by the trademark owner that he objects to their sale of the goods for the purposes of re-

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\[31\] This prohibition had been communicated to Levi Strauss' buyers orally and in writing, but was not contained in its purchase agreements in the United States, Mexico and Canada. \textit{Id. ¶ 25.}
sale, but the owner has not imposed on them any contractual restrictions on the manner in which the goods may be disposed of.\(^\text{32}\)

After considering the opinions of various member states about the sufficiency of implied consent, the Court noted that because consent in this situation had the serious effect of waiving the rights of the trademark holder, "consent must be so expressed that an intention to renounce those rights is unequivocally demonstrated…. Such intention will normally be gathered from an express statement of consent." However, the Court continued, consent may be implied in some cases:

...from facts and circumstances prior to, simultaneous with or subsequent to the placing of the goods on the market outside the [European Economic Area] which, in the view of the national court, unequivocally demonstrate that the proprietor has renounced his rights.\(^\text{33}\)

The Court went on to state that themere silence of the E.U. trademark owner is insufficient to show the necessary unequivocal consent, as is the trademark owner’s failure to communicate his opposition to third party sales in the European Union or his failure to provide either contractually or physically on the trademarked product that consent is not being given.\(^\text{34}\)

The Court further held that it is irrelevant whether the reseller of the goods knew or did not know that the trademark owner objected to the resale in the European Union.\(^\text{35}\)

The ECJ's decision, while specifically addressing only Levis jeans,\(^\text{36}\) had widespread implications for other gray market products commonly sold throughout the European Union, such as perfumes, clothing, cosmetics, sneakers, watches, alcohol, and many other goods which are imported from

\(^{32}\)\text{Id.} \^\text{28}. It is important to note that Tesco and Costco were not disputing the necessity of the trademark holder’s consent for resale of goods it has not yet sold in the European Union. Instead, they argued that such consent could be implied where the trademark owner did not contractually prohibit, or indicate on its goods, that buyers in non-E.U. countries were forbidden to re-sell the goods the countries of purchase.

\(^{33}\)\text{Id.} \^\text{45}-\text{47}.

\(^{34}\)Levi Strauss v. Tesco, \textit{supra} note 1, \^\text{55-57}, 60, 64.

\(^{35}\)\text{Id.} \^\text{66}. Tesco admitted that it was aware of Levi Strauss’ desire that its jeans not be sold in the European Union except through authorized retailers, but Costco had claimed that it was unaware of Levi Strauss’ wishes in this regard. \textit{Id.} \^\text{26}.

\(^{36}\)After the \textit{Levi Strauss} decision, Tesco and Costco (along with other retailers) stated their intention to purchase Levis in other E.U. countries and resell them in the United Kingdom at prices lower than Levis retail outlets (which, of course, is allowable under the regional exhaustion principle). \textit{See, e.g.}, Ellison, \textit{supra} note 2; \textit{European Judges Rule for Levi Strauss Jeans Against Tesco}, \textit{AGENCE FRANCE-PRESSE}, Nov. 20, 2001; \textit{Tesco to Carry On Selling Cut-Priced Levi Jeans Even After ECJ Ruling}, \textit{AFX (U.K.) NEWS}, Nov. 20, 2001; Taylor, \textit{supra} note 2 (quoting Safeway as saying it would sell 120,000 pairs of Levis purchased within the EEA).
abroad and sold through unofficial channels in the European Union, usually at cheaper prices than those charged by the trademark owners. Because the *Levi Strauss* decision ends many such sales, it was highly criticized in E.U. countries. For example, the London *Daily Telegraph* complained:

This [decision] is just another example of the mess our potty laws are getting us into... It is touching to think that Levis are so tricky to get right that the makers are worried lest you buy the wrong size, but this really is a load of old tosh. Levi Strauss is merely trying to protect its margins here, which are as fat as the average wearer of the product in their home country [the United States]... [T]he European Court of Justice sees no contradiction between allowing [gray market] imports from inside the E.U. and barring them from outside. This ruling may be splendidly communautaire, but it is clearly not in the interests of British consumers, and ensures that we will continue to pay a price in pounds equal to what American buyers pay in dollars, and not just for branded jeans.

Consumer advocates complained that the ECJ’s ruling was ‘‘appalling’ because it inhibit[s] consumers’ access to lower-priced branded goods and restrict[s] their choice of where to buy them.’’ The British Labour Party’s spokesman on consumer affairs in the European Parliament described the ECJ’s decision as a ‘‘real blow to consumers who seek to buy legitimate branded goods at the best available prices throughout the E.U.’’

Most of the criticism of the ECJ’s ruling was wrongly aimed at the Court and its decision, although given the language and legislative history of the Trademark Directive and the case law thereunder, the Court’s holding was unquestionably correct. Complaints would have been more appropriately aimed at the Trademark Directive and the European Commission,

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38 Cowell, *supra* note 3. While acknowledging that its jeans were more expensive in the European Union than in the United States, Levi Strauss claimed that the European price reflected higher costs of doing business in Europe, including taxes (especially the VAT tax, which does not exist in the United States), fuel and import costs, and higher wages and employee benefit costs. Further, Levi Strauss argued that as a brand owner, it had spent a great deal on research and development to improve its products and on advertising to sell its products to the public, and that discount chains such as Tesco should not be allowed to ‘‘free ride’’ on its expenditures. *Id.*

39 *EU Backs Levi on Cheap Jeans Case*, *supra* note 2. In contrast, rather than blaming the Court for maintaining high prices in the EEA, *The Guardian* queried, ‘‘Why are British shoppers so mustard keen to slip on a pair of overpriced 501s? Why, say, would we not rather don a comfortable pair of unbranded corduroys? The answer, should we be honest enough to admit it, is that we crave the image that Levi has spent considerable funds conjuring up through countless high-profile publicity campaigns. Perverse it may be, but to slash the price of 501s – to commoditise them – would destroy consumer interest in the product at a stroke. The British public often enjoys a ‘reassuringly expensive’ purchase.’’ *It’s Not Anything in the Jeans*, *THE GUARDIAN*, NOV. 21, 2001, available at 2001 WL 30418062.
the body which chose the doctrine of regional exhaustion and alone has the power to change it.\textsuperscript{40} However, before rushing headlong into advocating that the European Union should adopt international exhaustion, critics of the European Union’s present system should carefully consider the consequences of the international exhaustion system they are now so keen to adopt, as well as other alternatives that may better balance the interests of both consumers and manufacturers.

III. INTERNATIONAL EXHAUSTION

International exhaustion regimes\textsuperscript{41} are certainly the most consistent with the goal of free trade because they seek to give consumers in all countries where demand exists equal access (or as close to equal as possible) to goods, regardless of their origin country, and let the market, rather than the trademark holder, decide on their price. Once a trademark owner sells a product anywhere in the world, the new owner is able to re-sell it anywhere else at the lowest price the market will bear.

A second argument for the superiority of international exhaustion is based on the legal concept of the “trademark,” and asserts that a trademark owner should enjoy only limited protection. This view states that the purpose of a trademark is simply to act as a “badge of origin,” assuring a consumer that a product is genuine and was produced by the manufacturer that the consumer expects (usually the owner of the trademark). The trademark owner gains the benefit of the trademark when it makes its first sale of the item, no matter where that sale is made; although the trademark will continue to protect consumers further down the chain of sale by providing the desired assurances, the trademark owner should not gain additional and superfluous benefits by continuing to restrict the sale of the product or control its price or distribution. International exhaustion proponents argue that:

\footnotesize{\textsuperscript{40} Some critics understood this. For example, the Bureau European des Unions de Consommateurs (European Consumers Union) stated that “[t]he decision in the Tesco/Levis case … is bad news for European consumers, and clear proof that the current law on trademarks needs to be changed.” \textit{Consumer Lobby Calls for Change in EU Trademark Laws After Levi/Tesco Case}, AFX NEWS SERVICE, Nov. 20, 2001, available at 2001 WL 304127899. The British Consumers’ Association called the Trademark Directive, \textit{supra} note 8, a “ridiculous, outdated and fundamentally unfair piece of legislation.” Voyle, \textit{supra} note 2. After the ECJ decision was announced, Tesco said that its next step was to lobby the Commission and the British government to change the Trademark Directive into an international exhaustion regime. Cowell, \textit{supra} note 2; Ellison, \textit{supra} note 2; \textit{EU Backs Levi in Cheap Jeans Case}, \textit{supra} note 2.

\textsuperscript{41} Countries which have adopted international exhaustion regimes include Argentina, Australia, Brazil, Canada, Japan, Paraguay, Mexico, Singapore, Switzerland, and Venezuela. See International Exhaustion of Industrial Property Rights, The Economic Consequences of the Choice of a Regime of Exhaustion in the Area of Trademarks (International Association for the Protection of Intellectual Property Summary Report (2001)), at http://www.aippi.org/reports/q156/q156-Summary-e.htm [hereinafter AIPPI Report].}
[f]rom a welfare perspective, the market power entailed in patents and copy-right[s] poses a cost to society, which ... is outweighed by the benefits that the creation of new knowledge and information brings to society. [Trademarks], in contrast, are not designed to confer any direct market power. Trademarks do not restrict imitation or copying of protected goods as long as they are sold under a different brand name. This difference is reflected in the attribute that protection of [patents and copyrights] is limited to a fixed time period (e.g., 20 years for patents) in order to minimize the costs of a distorted market structure, whereas [trademarks] can endure virtually indefinitely provided they remain in use.

A third argument for international exhaustion (the most common one) is end-oriented, finding justification solely in the desirability of cheaper prices for consumers: any restrictions on who can sell a product, or at what price they may sell it, harms the consumer. While few would argue that a trademark holder deserves no protection at all, once he has sold his product anywhere in the world, consumer advocates argue that the resale of goods by parallel importers leads to increased intra-brand and inter-brand competition throughout the world, which in turn leads to a reduction in consumer prices and, presumably, a boost in consumer spending.

42 Carsten Fink, Entering the Jungle of Intellectual Property Rights - Exhaustion and Parallel Imports, Address Before the Fraser Institute (Apr. 19, 1999) at 9, at http://wwwl.worldbank.org/wbiep/trade/modules.html. An adjunct of this argument is that “...it is not the function of trademarks to endow on trademark holders a licence to make large monopoly profits.” Patrick Kenny & Patrick McNutt, Competition, Parallel Imports and Trade Exhaustion: Two Wrong From a Trademark Right, Republic of Ireland Competition Authority, Discussion Paper No. 8 (1999) at 10, at http://www.tca.ie. This criticism misuses the term “monopoly,” however, for antitrust and competition laws in most countries clearly hold that it is not possible to illegally “monopolize” one's own product because every manufacturer inherently has a natural monopoly over its own products. See, e.g., U.S. v. E.I. DuPont de Nemours & Co., 351 U.S. 377, 393 (1956); Int'l Logistics Group, Ltd. v. Chrysler Corp., 884 F.2d 904, 908 (6th Cir. 1989); Key Fin. Planning Corp. v. ITT Life Ins. Corp., 828 F.2d 635, 643 (10th Cir. 1987); Dunn & Mavis, Inc. v. Nu-Car Driveaway, Inc., 691 F.2d 241, 244 (6th Cir. 1982); TV Communications Network, Inc. v. ESPN, Inc., 767 F. Supp. 1062, 1071 (D. Colo. 1991); Northeastern Educ. Television of Ohio, Inc. v. Educ. Television Ass'n of Metro Cleveland, 758 F. Supp. 1568, 1578 (N.D. Ohio 1990). Further, the vast majority of trademark owners do not have monopolies (in the antitrust sense) in the markets in which their trademarked products compete because they typically compete with interchangeable, substitute goods and are thus limited in their power to increase prices and their ability to price discriminate without losing sales to such substitute goods. Fink, supra note 42, at 12. However, in markets where there is little or no inter-brand competition or substitute products, advocates of free trade argue that “issues on monopolies should be addressed through competition law rather than by further limiting the trade mark rights.” Silvia Zarpellon, The Scope of the Exhaustion Regime for Trade Marks Rights, 9 E.C.L.R. 382, 384 (2001).

the trademark holder (such as warranties, after-sales services, and the like) in exchange for lower prices.44

However, there are many critics of international exhaustion as well. The “national sovereignty” argument asserts that all countries have an inherent interest in protecting their domestic trademark holders (primarily manufacturers and other industries) from intra-brand competition from foreigners. National exhaustion regimes (the most protectionist) shield trademark owners as much as possible from such competition by prohibiting all sales of trademarked products imported from another country without the trademark owner’s permission. Regional exhaustion regimes (such as the European Union’s) expose their trademark owners to domestic competition from third-party sales of trademarked products imported only from other countries within the region. In both cases, countries adopting such regimes have rejected international exhaustion because of its inherent disadvantages to their domestic trademark holders.45

Critics of international exhaustion also argue that price discrimination (setting different prices in different markets) by trademark owners actually can be desirable and welfare-enhancing from a global perspective if prices in rich countries are higher than those in poor countries, because the former “subsidize” the latter.46 In this way, “[E]veryone is better off: consumers in the low price countries are able to buy the product and they make some contribution to the overhead for the benefit also of those in the high cost countries.”47 By dampening trademark owners’ ability to price discriminate


45 Countries which have adopted either national or regional exhaustion (aside from the EU countries) include Bulgaria, the Czech Republic, Hungary, and Romania. AIPPI Report, supra note 41, at 2; see also discussion infra Sec. IV. The United States’ system is nominally a national one, but the “common control” exception renders it closer in practical terms to an international system in many circumstances.

46 While this is the most commonly-understood definition of “price discrimination,” the concept might more accurately be described as “two or more similar goods ... sold at prices that are in different ratios to marginal costs.” Hal Varian, Price Discrimination, in HANDBOOK OF INDUSTRIAL ORGANIZATION 598 (Richard Schmalensee & Robert D. Willig, eds., 1989).

47 Fink, supra note 42, at 11.

between markets, critics of international exhaustion argue that such systems discourage trademark owners from selling their goods at all in poor countries or other low-price countries because third parties can purchase the goods there, export them to higher-price countries, and undercut the trademark owner's prices in those markets. For instance, one critic has pointed out that the recent commitment of several international pharmaceutical companies to sell AIDS drugs to South Africa at the lowest rate in the world will be very short-lived if distributors in South Africa are allowed to ship the drugs to the United States, United Kingdom, and other E.U. countries to sell at higher prices.

Furthermore, some argue that national and regional exhaustion regimes help trademark owners protect their investments in marketing by preventing gray market sellers from "free riding," which in turn allows the trademark owner to keep its prices low in that nation or region. National and regional exhaustion also protects trademark owners' (and their licensees') abilities to offer pre-sale and after-sale services and warranties or guarantees that most gray market sellers do not provide. Such services and warranties are paid for by the trademark owner and necessitate its charging higher prices than the gray market seller, who has no such costs. Thus, the argument goes, differential pricing is in the best interests of consumers.

49 See Kenny & McNutt, supra note 42, at 12. Of course, maximizing global welfare does not necessarily maximize each country's individual national welfare or the welfare of individual consumers. Indeed, a system of international exhaustion, in theory, would tend to decrease prices in high-price countries (because imports from low-price countries would enter their markets) and increase prices in low-price countries (because trademark holders would set their prices accounting for the possibility that they will become sources of parallel imports into high-price countries). See, e.g., OECD Report 2002, supra note 48, at 16 ("It is as if all the countries that formerly had lower prices ... move in the direction of being a single market with [higher-price countries]").


51 It is contended that due to the gray marketers' free promotional ride, trademark owners "have less incentive to market, and ultimately, develop products, and as a result such competition may cause an increase in unemployment because authorized dealers will be forced to close." Donna Hintz, Battling Gray Market Goods with Copyright Law, 57 ALB. L. REV. 1187, 1189-1190 (1994). However, a recent in-depth study of parallel imports concluded that the global welfare effects of such free riding depend on whether there is vigorous competition in all pertinent markets, and that parallel importers' free riding on trademark owners is neither inherently beneficial nor detrimental to global markets. See OECD Report 2002, supra note 48, at 8-9.

52 However, some gray market sellers offer their own warranties and services distinct from the trademark owners, although this is far less common than trademark owners providing such services.
because the threat of parallel imports inherent in an international exhaustion system would lead many companies to stop or drastically curtail their marketing and sales support activities.\footnote{See Fink, \textit{supra} note 42, at 15-16. Proponents of gray market imports refute this argument by pointing out that "[t]he majority of branded goods subject to parallel imports do not require after sales service (perfumery, cosmetics, toiletries, clothing, soft and hard drinks etc.)...[A]fter sales service provided by the parallel importer is in many cases equal if not superior to the [original producer]." European Parallel Importers Coalition, \textit{The Case for Re-introducing Global Trademark Exhaustion in EU Legislation, Position Paper} (2001) at 2, at http://www.europarl.eu.int/hearings/20010410/juri/5_frenkel.pdf [hereinafter EPIC Position Paper].}\footnote{See John C. Hilke, \textit{Free Trading or Free Riding: An Examination of the Theories and Available Evidence on Gray Market Imports}, 32 \textit{World Competition} 75 (1988) (discussing the reasons that exchange rate fluctuation might partially explain gray market imports' lower prices where trademark holders fail to immediately adjust their prices to reflect daily changes in exchange rates).}

Critics of international exhaustion further argue that the seemingly cheaper prices of gray market imports in countries following international exhaustion are really a red herring. The primary reasons that trademark holders' prices are often higher than gray market importers', they assert, are the costs of the aforementioned marketing and after-sales activities; currency exchange fluctuations;\footnote{See James J. Flaherty, Jr., \textit{Trademarks and the Common Control Exception: A Study in Confusion: Lever Bros. Co. v. United States}, 9 \textit{Conn. J. Int'l L.} 325, 326 n.4 (1994); see also OECD Report 2002, \textit{supra} note 48, at 7.}\footnote{See U.K. Trade and Industry Report, \textit{supra} note 44.} lower costs of manufacture, distribution, and/or transportation in some countries than in others; the trademark holder's need to vary the qualities of a product to fit local preferences or needs in different countries; the absence of competition in some countries; lower or non-existent marketing costs, duties and other taxes in different markets; differences in market structures;\footnote{National Economic Research Associates, S.J. Berwin & Co. and IFF Research, \textit{The Economic Consequences of the Choice of a Regime of Exhaustion in the Area of Trademarks – Final Report for DGXV of the European Commission} (1999), at http://europa.eu.int/comm/internal_market/en/indprop/tm/report.pdf [hereinafter NERA Report].} brand owners wishing to offload surplus stock; brand owners producing additional goods in order to boost sales figures; differences in handling or promotion costs; and differences in product quality or ingredients.\footnote{See OECD Report 2002, \textit{supra} note 48, at 7.} Indeed, many persuasive studies, such as the exhaustive Report for the European Commission by the National Economic Research Associates,\footnote{See John C. Hilke, \textit{Free Trading or Free Riding: An Examination of the Theories and Available Evidence on Gray Market Imports}, 32 \textit{World Competition} 75 (1988) (discussing the reasons that exchange rate fluctuation might partially explain gray market imports' lower prices where trademark holders fail to immediately adjust their prices to reflect daily changes in exchange rates).}\footnote{See U.K. Trade and Industry Report, \textit{supra} note 44.}\footnote{See James J. Flaherty, Jr., \textit{Trademarks and the Common Control Exception: A Study in Confusion: Lever Bros. Co. v. United States}, 9 \textit{Conn. J. Int'l L.} 325, 326 n.4 (1994); see also OECD Report 2002, \textit{supra} note 48, at 7.} indicate that while increases in gray market imports tend to lower prices in the short term, the positive effect on pricing disappears in the long term due to factors such as transport costs, health and safety legislation, technical standards, labeling differences, import duties and import quotas. Further, the NERA Report found that despite the fact that the E.U. practices regional exhaustion, there are still "substantial price differentials" on the same products between E.U. member states:

Some of these differentials may reflect factors such as transportation and distribution costs, transitory exchange rate movements and tax differences, but it appears that parallel imports [between E.U. states] do not prevent trademark holders from price discriminating across national markets... When estimating the effect of freeing parallel imports on E.U. retail prices and trademark holders’ profits, the [NERA Report found] only small or moderate decreases in prices (on average less than 5 percent), but marked falls in profits [for trademark owners].

Another oft-cited reason to limit gray market imports, at least with respect to some products, is that they may have different qualities or ingredients than goods sold through the trademark owner's official distribution channels, and this may lead to the deception or confusion of consumers. For example, due to differing safety standards, quality control standards, or consumer preferences, a product sold in Great Britain may differ substantially from the product sold under the same brand name, with the same label, at a cheaper price, in the United States. If imports of such a product from the United States were freely allowed on the market in Britain, most British consumers would not be aware of the differences in the product (even if the packaging was different than that normally used in Britain), and these consumers would be surprised and perhaps disappointed in the product they purchased, thus decreasing their loyalty to the brand, discouraging them from purchasing that product again and damaging the value of the trademark and goodwill invested in and earned by the trademark owner.

In some cases, it has even been suggested that parallel imports undermine the enforcement of technical, health, and safety standards in the importing country, and that allowing free importation and sale of such goods may increase the occurrence of counterfeits because customs agents no longer will closely examine imported trademarked goods, and fakes may slip into the market more easily.

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[58] Fink, supra note 42, at 20-21.
[59] See infra notes 86-88, and accompanying text.
[60] Fink, supra note 42, at 15-16; see also Hintz, supra note 51, at 1189. Gray market proponents retort that the provision of adequate information, such as disclaimers attached to parallel imports of different quality or characteristics, largely eliminates the risk of confusion, increases the choices of consumers, and provides lower prices. See Fink, supra, at 16. Further, they argue, international exhaustion laws may be drafted to exclude imports that are different from those sold in the relevant country, so that only identical goods are subject to the exhaustion regime.
[61] Zarpellon, supra note 42, at 384; see also OECD Report 2002, supra note 48, at 13 (bans on parallel imports “facilitate keeping pirated and counterfeit goods out of the market because they dispense with the need to prove that such goods have been illegally produced. It would be sufficient to show that their importation was unauthorized.”) While this may be true, many argue that it is inappropriate to attack an illegal activity such as counterfeiting by
The last major argument against international exhaustion is based on the fact that many governments worldwide (particularly in certain industries such as pharmaceuticals) intervene in private markets by controlling prices or regulating companies' rates of return. Permitting gray market imports of trademarked goods from countries with such "artificially" low prices sets up unfair intra-brand competition in intervention-free countries: "From an economic perspective... it could be reasoned that consumers in a particular country would benefit from low-priced parallel imports regardless of the cause of low prices. However, if significant 'leakage' from price-controlled countries would lead to markedly lower worldwide profits of [trademark] holders, they may decide to stop serving price-controlled markets altogether."

In summary, it is crucial for those who urge that the European Union adopt an international exhaustion regime, understand and weigh these arguments for and against such a policy shift in the European Union in particular. A side-by-side comparison of these arguments is analytically useful:

limiting a legitimate activity such as the legal importing of genuine items. See Fink, supra note 42, at 15-16; EPIC Position Paper, supra note 53, at 3 ("[T]he inability of the relevant customs authorities to deal with this problem is hardly a reason to disallow a perfectly legitimate trade.")

62 See Korah, supra note 48, at 973.
63 Fink, supra note 42, at 15.
64 Most exhaustive studies that attempt to characterize international exhaustion (or the lack of barriers to parallel imports) conclude that the evidence is ambiguous, and that a particular country's decision regarding adoption of international exhaustion must account for specific economic and political factors in that country, the strength (in market share) of domestic trademark holders vis-à-vis those in other countries, which market sectors are represented (and to what extent) in that country, and many other microeconomic factors. See, e.g., Keith E. Maskus & Yongmin Chen, Vertical Price Control and Parallel Imports: Theory and Evidence, Research Paper (2000), at http://www.econ.worldbank.org/files/1216_wps2461.pdf (findings of their study were "...sufficiently inconclusive to make confident claims about policy"); see also NERA Report, supra note 57, at 118-124 (identifying significant variances in the effect of international exhaustion on ten E.U. market sectors).
<table>
<thead>
<tr>
<th>For International Exhaustion</th>
<th>Against International Exhaustion</th>
</tr>
</thead>
<tbody>
<tr>
<td>Most consistent with global free trade (a basic goal of the European Union)</td>
<td>All countries have the right to, and interest in, protecting their domestic industries and trademark holders</td>
</tr>
<tr>
<td>Justified by cheaper prices for consumers and increased competition among sellers</td>
<td>Some studies show that cheaper prices are only temporary, and that international exhaustion cuts profits without long-term benefits for consumers</td>
</tr>
<tr>
<td>Price discrimination is inherently unfair and contrary to free trade; consumers in developed and developing countries will benefit from international exhaustion via lower prices, while those in poor countries will still receive the same goods they did before</td>
<td>Price discrimination inherent in national and regional exhaustion systems enhances global welfare by subsidizing poor countries; international exhaustion will prevent trademark owners from selling in poor countries, and although these goods may be imported from other countries, they will be more expensive and perhaps unaffordable</td>
</tr>
<tr>
<td>Trademark owners’ investments in R&amp;D, advertising, and marketing are &quot;costs of doing business&quot; that they will incur with or without international exhaustion</td>
<td>International exhaustion allows third party sellers to “free ride” on the trademark owner’s investments in R&amp;D, advertising and marketing</td>
</tr>
<tr>
<td>Many consumers would gladly forego the warranties, guarantees, spare parts, and after sales services that trademark holders and their authorized dealers offer in exchange for a lower price</td>
<td>Gray market sellers usually do not offer warranties, guarantees, spare parts, and after sales services that trademark holders and their authorized dealers offer, thereby decreasing the value of the trademarked good and the goodwill of the customer toward the trademark holder</td>
</tr>
<tr>
<td>Warning labels would be sufficient to warn consumers if an imported trademarked product is different than the domestic type sold by the trademark owner in that country; alternatively, differing products could be excepted from the international exhaustion system</td>
<td>Consumers will be confused by imported products which are different in quality or ingredients, and warning labels will not be sufficient to prevent consumer confusion or disappointment</td>
</tr>
<tr>
<td>All consumers, regardless of where they live, should have access to the lowest prices they can get from any seller in their home market</td>
<td>Allowing export of goods from countries exercising price controls, for sale in other countries, is unfair to the trademark owner</td>
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IV. THE HYBRID U.S. EXHAUSTION SYSTEM

The United States' trademark exhaustion system is a hybrid of national and international exhaustion. While the U.S. system was originally intended to be national in scope (i.e., the most protectionist), it provides for a broad exception that expands exhaustion to an international level in specific circumstances which have become far more frequent than when the exception was first implemented. As will become apparent, this exception would have applied if the Levi Strauss case had been brought in U.S. courts, and Tesco's importation and sale of the jeans without Levi Strauss' permission would have been allowed in the United States. Further, as noted below, increasing globalization of industry will guarantee that the exception triggering international exhaustion will operate in the future to allow even more gray market goods into the United States.

In order to understand the U.S. system of trademark exhaustion, it is necessary to examine the two relevant sets of laws: the Tariff Act and its applicable Customs Regulations, and the Lanham Act portions of the Trademark Act.

A. Tariff Act § 526 and Customs Regulation § 133.23

Section 526 of the Tariff Act (19 U.S.C. § 1526) ("§ 1526") provides, in relevant part:

(a) ... [I]t shall be unlawful to import into the U.S. 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....

This statute clearly prohibits all imports by a third party of goods which are trademarked in the United States but were manufactured abroad, regardless of whether the U.S. trademark owner or someone else engaged in a "first sale" of the product in the foreign country. However, Customs Regulation § 133.23, known as the "common control" exception to §1526, significantly narrows the prohibitions of the statute and allows many covered goods into the country anyway:

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65 19 U.S.C. § 1526 (2002). The statute and its regulations provide for exceptions when an individual is importing the product for his or her own personal use. Subsections (b), (c), and (f) of § 1526 provide that merchandise imported into the United States in violation of this section is subject to seizure and forfeiture, and that anyone dealing in such merchandise may be subject to injunction, a requirement to export or destroy the merchandise, damages for wrongful use of the trademark, and other civil penalties, in addition to any other civil or criminal penalties that might apply under other statutes.
19 C.F.R. § 133.23 Restrictions on importation of gray market articles.

....(d) Relief from detention of gray market articles. 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 foreign trademark or 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...; and/or

(2) For goods bearing a genuine mark applied under the authority of 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, that the merchandise as imported is not physically and materially different, as described in § 133.2(e) [the “Lever Rule”], from articles authorized by the U.S. owner for importation or sale in the United States....

Thus, where a trademark was applied in a foreign country by the United States trademark holder itself, or an entity with which it is subject to “common ownership or control,” and the product is not materially different from a product authorized by the United States trademark holder for sale in, or import into, the United States, then the imported product will be allowed into the United States for sale in competition with the U.S. trademark...

66 Elsewhere in the regulation, “restricted gray market articles” are defined as:
(a) ...foreign-made articles bearing a genuine trademark or trade name identical with or substantially indistinguishable from one owned and recorded by a citizen of the United States or a corporation or association created or organized within the United States and imported without the authorization of the U.S. owner. “Restricted gray market goods” include goods bearing a genuine trademark or trade name which is:

(1) Independent licensee. Applied by a licensee (including a manufacturer) independent of the U.S. owner, or
(2) Foreign owner. Applied under the authority of a foreign trademark or trade name owner other than 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..., from whom the U.S. owner acquired the domestic title, or to whom the U.S. owner sold the foreign title(s); or
(3) “Lever-rule.” Applied by 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..., to goods that the Customs Service has determined to be physically a materially different from the articles authorized by the U.S. trademark owner for importation or sale in the U.S.

67 See 19 C.F.R. § 133.2(e) (2002).
68 Id. (emphasis added).
69 Under 19 C.F.R. § 133.23(d)(3) (2002), even if the product is physically and materially different from the product authorized for importation or sale in the U.S., compliance with a specific labeling requirement will qualify it for such importation and sale.
holder, even without its permission. The common control exception significantly distinguishes U.S. law on gray market imports from E.U. law, where the most meaningful criterion is whether the trademark owner itself has made a “first sale” of the product inside or outside the European Union. First sales by an affiliate of the trademark owner are irrelevant.

The logic behind the United States’ common control exception is that a foreign entity that is under common ownership or control with the U.S. trademark holder is, practically speaking, the same entity as the U.S. trademark holder, and therefore, its sale of a product overseas is essentially the same as the U.S. trademark holder itself selling the good there. Thus, the “first sale” in the foreign country is deemed to have exhausted the U.S. trademark holder’s rights. However, as discussed in the cases below, to come within the common control exception, the product must be identical in all material respects to the trademarked good that is sold in the United States.

The common control exception was adopted by the Customs Service in 1936 as part of the regulations under the Tariff Act of 1922, which was passed in response to A. Bourjois & Co. v. Katzel (a case later overturned by the Supreme Court). The Bourjois decision had allowed the gray market importation of goods by a foreign manufacturer even though it had contracted with a U.S. company for the latter to be the exclusive American dealer of the goods, thereby implicitly promising that the U.S. company would have no competition in selling the trademarked goods. Congress’ purpose in enacting the Tariff Act was to protect U.S. manufacturers and sellers from such double-dealing. The common control exception was intended to prevent foreign companies doing business in the United States (or having U.S. subsidiaries) from gaining the protection of the exception; if they had American subsidiaries or affiliates, then Americans could import their goods from overseas and sell them in competition with the foreigner’s subsidiary/affiliate in the United States. The common control exception thus originated as a nationalist, protectionist measure.

This principle is also recognized in U.S. antitrust law. In Cooperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 771 (1984), the Supreme Court held that a corporate parent and its subsidiary cannot be deemed to have conspired with each other under § 1 of Sherman Act because they are basically the same entity, i.e., they have “complete unity of interest. Their objectives are common...; their general corporate actions are guided or determined not by two separate corporate consciousnesses, but one.”

The validity of the common control exception was upheld by the U.S. Supreme Court in Kmart Corp. v. Cartier, Inc., 486 U.S. 281 (1988). In that case, the Supreme Court identified three possible types of gray market goods: (1) a U.S. firm buys the right to use a trademark to sell foreign-made products in the United States, but the foreign trademark owner then either sells the goods in the United States itself, or sells goods to someone else who sells them in United States, in competition with the U.S. trademark holder (the scenario in
In the years since the passage of the common control exception, however, a huge proportion of American manufacturers and trademark holders have begun overseas operations and sales; they are selling their goods abroad either directly, through subsidiaries or related corporations, or through licensed dealers. The effect of the common control exception today, contrary to its original intent, is that these American corporations are subjected to increased competition at home from their own goods thanks to gray market importers (American and foreign alike) purchasing those goods abroad and bringing them to the United States to sell. Indeed, the only U.S. trademark holders who are unaffected by the common control exception are (1) those who have no overseas sales, and (2) those who hold U.S. trademark rights to products whose overseas trademarks are owned by or licensed to entities to which they are unrelated (as shown in some of the cases discussed below). Thus, the common control exception nearly subsumes the United States' basic rule of national exhaustion, rendering the U.S. system an international one for most intents and purposes. In some ways, the U.S. system is even more conducive to gray market imports than the average international exhaustion system because it allows imports of products which were sold abroad not just by the U.S. trademark holder itself, but also by affiliates of the U.S. trademark holder. Thus, the U.S. system, although originally intended to be protectionist, has developed into one offering little protection at all for many domestic trademark holders.

To understand how the trademark statutes, regulations and exceptions actually function in the United States, it is useful to examine several court decisions involving the Tariff Act and the common control exception. We begin by examining cases in which the importation of foreign-trademarked goods was disallowed, then cases in which the importation was allowed under the common control exception.

In *U.S. v. 83 Rolex Watches*, 1993 Rolex's U.S. distributor (Rolex U.S.) was under common ownership with the worldwide Rolex distributor but not with the foreign trademark holder. Sam's Wholesale Club (a U.S. chain
similar to the Tesco and Costco hypermarkets in Europe) had bought Rolexes overseas which had been sold there by the worldwide distributor, and imported them into the United States for sale, arguing that because Rolex U.S. was related to the foreign Rolex distributor (though not the foreign trademark holder), its trademark rights were exhausted by the overseas sales. The Fifth Circuit rejected this argument, saying that for the common control exception to apply, the U.S. trademark holder had to be a subsidiary of, or under the same ownership as (i.e., a sister corporation of), the foreign trademark owner, not just the distributor. Here, although Rolex U.S. and the foreign trademark owner had a "close and profitable business relationship" through their distribution contract, their relationship was not close enough to invoke the common control exception, so § 1526 required the Customs Service to disallow Sam's importation of the watches. 7

Similarly, the Ninth Circuit Court of Appeals disallowed gray market imports of perfumes in U.S. v. 89 Bottles of Eau de Joy. 5 The perfume at issue was manufactured by Patou-Paris, the owner of the foreign trademark, and was distributed in the United States by a corporation to which Patou-Paris had assigned the U.S. trademark but to which it was otherwise unrelated. The court held that because the foreign trademark owner and the U.S. trademark licensee were not related except contractually, the common control exception did not apply and Patou-Paris' sales of the perfume in Europe did not exhaust the American distributor's trademark in the United States. 6

Likewise, in Premier Dental Products Co. v. Darby Dental Supply Co., 7 the U.S. trademark holder and the German manufacturer/trademark holder for a dental product were not related but had a distribution contract. The German company had sold dental products to retailers in Europe, who sold to a third party who sought to import the products to the United States to resell in competition with the U.S. trademark holder. The Third Circuit Court of Appeals found that the U.S. trademark holder and the German trademark holder were not sufficiently related for the common control exception to apply, and enjoined the importation of the products by the third party. 8

In contrast, the Third Circuit Court of Appeals applied the common control exception in Weil Ceramics and Glass, Inc. v. Dash, 9 wherein Weil Corporation owned the U.S. trademark for Lladro porcelain, and was a wholly-owned subsidiary of a sister corporation to the foreign Lladro manu-

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74 Id. at 515.
75 797 F.2d 767 (9th Cir. 1986).
76 Id. at 771-72.
77 794 F.2d 850 (3d Cir. 1986).
78 Id. at 858, 860.
79 878 F.2d 659 (3d Cir. 1989).
manufacturer/trademark holder (i.e., the U.S. trademark holder was the “nephew” of the foreign trademark holder). The defendant, Jalyn Corporation, purchased Lladro figurines in Europe and imported them into the United States to compete with Weil, which sold identical figurines. The Third Circuit Court of Appeals held that the corporate relationship of Weil and the European manufacturer was sufficiently close to apply the “common control” exception and allow Jalyn’s importation and sale of the Lladro products in competition with Weil. The court’s rationale was that the American trademark holder “enjoy[s] every benefit that inheres in the corporate relationship [with the European manufacturer] .... More significantly, that relationship also provides the opportunity for the foreign manufacturer’s control of the United States market—under the auspices of the trademark act—that [the common control exception] intended to preclude.”

It is interesting to note that the facts of the Weil case were very similar to those in Levi Strauss v. Tesco, except that the goods were being imported from Europe into the United States rather than vice versa. Indeed, it is highly likely that if Levi Strauss had brought suit in a U.S. court to stop imports into the United States of Levis originally sold in the United Kingdom, the American court would have found the common ownership of Levis U.S. and Levis U.K. to be determinative. The exception would have applied, and the gray market importation and sale of the Levis in the United States would have been allowed.

It is ironic that §1526 and the common control exception, originally intended as protectionist measures for U.S. industry, are now often used against U.S. companies by foreigners seeking to import goods into the United States to sell in competition with U.S. trademark holders. In the

80 Id. at 666. Again, this commentary by the court confirms that the purpose of the common control exception was to protect U.S. companies from foreign competitors who set up American subsidiaries to sell their products in the United States.

81 See supra note 72, and accompanying text.

82 In cases where the common control exception applies to allow the import and sale of gray market goods in the United States, the American trademark owner may still be able to sue the importer/seller for damages in a private cause of action for trademark infringement under the Trademark Act. Section 1526(c) of the Tariff Act provides: “Any person dealing in any such merchandise may be enjoined from dealing therein within the United States or may be required to export or destroy such merchandise or to remove or obliterate such trademark and shall be liable for the same damages and profits provided for wrongful use of a trademark, under the provisions of sections 81 to 109 of Title 15 [now contained in 15 U.S.C. §§ 1051-1127 (the Trademark Act)].” See, e.g., Orig. Appalachian Artworks, Inc. v. Granada Elec., Inc., 816 F.2d 68, 71 (2d Cir. 1987) (applicability of common control exception does not preclude trademark owner from pursuing private remedies against the importer/seller of gray market goods); Olympus Corp. v. U.S., 792 F.2d 315, 320-21 (2d Cir. 1986) (upholding §133.23 because of long Congressional acquiescence to it and because trademark holder still has private right of action for damages even when exception applies); Vivitar Corp. v. U.S., 761 F.2d 1552, 1570 (Fed. Cir. 1985) (leaving open the possibility of
Levi Strauss v. Tesco  

Levi Strauss example above, Levi Strauss U.S. is the parent company and origina-
tor of the Levis trademark, and the U.K. company is a subsidiary of the
American parent, yet the common control exception would operate to allow
U.K. Levis into the United States and subject Levis U.S. to increased
competition.

Despite the common control exception's disadvantages to multina-
tional U.S. corporations today, there have been no serious attempts by the
U.S. Congress to modify or abolish the exception. Why? Clearly because
the common control exception is good for U.S. consumers—if goods sold
overseas by an affiliate of a U.S. company can be imported and resold in
the United States for prices cheaper than the U.S. company sells them, U.S.
consumers reap the benefits. For example, "off-price stores" such as T.J.
Maxx, Marshall's, Ross, and Loehmann's sell billions of dollars of gray
market designer clothing, shoes, perfumes, luggage, jewelry, china, and
other goods every year, taking advantage of the common control exception
to purchase such goods overseas and sell them in the United States for
lower prices than in department stores or boutiques. And no U.S. Con-
gressman wants to be known in his district as the one who sponsored a bill
to repeal a regulation benefiting consumers.

B. Lanham Act §§ 32, 42 and 43

Where gray market goods imported into the United States differ from
those sold in the United States by the American trademark owner, some
U.S. courts have allowed the American trademark holder to stop the
importation under the Lanham Act, the portion of the Trademark Act that
covers the importation of trademarked goods.

Section 32 of the Lanham Act prohibits the importation into the United
States of goods that are "counterfeit" or which "imitate" a valid U.S. regis-
tered trademark. Section 42 of the Lanham Act prohibits the importation
private action under § 1526 even when Customs allows importation under the common con-
trol exception); Disenos Artisticos E Industriales, S.A. v. Work, 676 F. Supp. 1254, 1272
(E.D.N.Y. 1987) (private remedies are available to the trademark holder under § 1526(c)
even where common control exception applies); Dial Corp. v. Encina Corp., 643 F. Supp.
951, 956 (S.D. Fla. 1986) (trademark holder had independent right of action against importer
of gray market products for violation of the Tariff Act, regardless of Customs Service's deci-
sion not to exclude the goods). However, such lawsuits are not very common.

83 TJX, the parent company of T.J. Maxx and Marshall's, is number 179 on the Fortune
500 list, having recorded revenues of $10.7 billion in 2001, and Ross Stores is listed at num-
er 509 on the Fortune 500 list, with $3 billion in revenue in 2001. See America's Largest
Corporations, at http://www.fortune.com/fortune/fortune500/0,14924,101,00.html. Loeh-
mann's stores recorded revenues of $386 million in 2001. See id.

84 "(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 a mistake or to de-
into the U.S. of goods that "copy or simulate" a valid U.S. registered trademark. Because these two sections specifically cover only "fake" goods or "fake" trademarks, when a product bearing a genuine foreign trademark is imported into the United States and is identical to the U.S.-trademarked product, § 32 and § 42 usually do not apply.

There is significant controversy, however, over whether § 32 and § 42 of the Lanham Act prohibit the importation of goods with genuine trademarks where the imported goods are different from those sold in the United States. Trademarked products that are sold in multiple countries frequently differ from country to country in their qualities, packaging, ingredients, or safety standards in order to accommodate cultural tastes, language differences, safety standards, or dispensing and marketing methods. Indeed, significant differences may exist between goods sold in different countries even where the products have the same name and same manufacturer. For example, in 1983, 50,000 units of Oil of Olay manufactured in Canada and then imported as gray market goods into the United States were pulled from U.S. shelves because they contained Red Dye #2, which is legal in Canada but not in the United States. A similar occurrence involved the importation into the United States of extra-fluoride toothpaste manufactured for countries without fluoride in their water supply. This toothpaste was poten-

ceive’ … shall be liable in a civil action by the registrant for the remedies hereinafter provided.” Lanham Act § 32, 15 U.S.C. § 114(1)(a). “Use in commerce” may mean importation, sale, advertising or almost any other commercial activity.

85 “[N]o article of imported merchandise… which shall copy or simulate a trademark registered in accordance with the [law]… shall be admitted to entry at any customhouse of the United States…” Id. § 42, 15 U.S.C. § 1124. Note that this section applies only to importation, not to general “use in commerce,” as is covered by § 32 and § 43 of the Lanham Act.

86 For example, in Matrix Essentials, Inc. v. Emporium Drug Mart, Inc., 988 F.2d 587, 590 (5th Cir. 1993), the Fifth Circuit found no Lanham Act violation because the goods that defendant was importing and selling had genuine foreign trademarks and were identical to those sold in the U.S. by the manufacturer’s U.S. distributors. Likewise, in NEC Electronics v. CAL Circuit Abco, 810 F.2d 1506, 1510 (9th Cir. 1987), the Ninth Circuit rejected NEC’s Lanham Act claim where NEC-Japan had bought microchips abroad, imported, and sold them in the United States. Because the Japanese and American NEC corporations were “commonly controlled” and the chips were identical to those that NEC sold in the United States, § 133.23 applied and the Lanham Act did not prevent Abco’s importation and sale of the chips in the United States. See also Summit Tech. Inc. v. High-Line Med. Instruments Co., 922 F. Supp. 299, 308-09 (C.D. Calif. 1996) (foreign manufacturer of eye laser systems brought suit under Lanham Act §§ 32 and 42 against importer who bought them abroad and sold them in United States; court granted importer’s motion to dismiss because goods were genuine and identical to those authorized for sale in the United States.); Weil Ceramics & Glass, Inc. v. Dash, 878 F.2d 659, 671-72 (3d Cir. 1989) (rejecting plaintiff’s attempts to prohibit importation of Lladro porcelain under § 32 of the Lanham Act because, inter alia, the goods at issue, which had been imported into the United States from Europe, were genuine and identical to those sold in the United States).

tially dangerous to U.S. consumers (especially children), most of whom have fluoridated water supplies in their homes. 88

Some American courts (including four influential Circuit Courts of Appeal and several federal district courts) have held that § 32 and § 42 of the Lanham Act prohibit the importation of such differing goods, even when sold abroad by an entity under common control with the U.S. trademark holder, because their differences from the U.S. trademarked goods essentially render them "non-genuine" in the United States, and/or because the differences in the products may confuse U.S. consumers and degrade the value of the U.S. trademark. 89 Lanham Act arguments were used in Lever Bros. Co. v. U.S., 90 in which “Sunlight” dishwashing liquid and “Shield” deodorant soap sold in Great Britain by Lever Bros. U.K., a close affiliate of Lever Bros. U.S., had been imported into the United States by a gray marketer. The U.S. Customs Service had allowed the importation under the “common control” exception, since Lever Brothers U.K. and Lever Brother U.S. were closely affiliated corporations. The imported products, although bearing the same name as Lever Bros. U.S.’s trademarked products, were substantially different than those sold in the United States due to varied consumer preferences in the two markets. For instance, “Shield” sold in the United States contained deodorant properties and FDA-certified colorants, which the U.K. version did not have, and also had a different smell. The “Sunlight” product sold in the United States was considerably more “sudsy” than that sold in the United Kingdom, and was specially formulated to work best in “soft water,” which is common in the United States but not in the United Kingdom. In addition, the packaging of both products was different in the United Kingdom and the United States. Lever Brothers claimed that the U.K. product did not meet the quality expectations of U.S. consumers, and showed several complaints from American consumers who unknowingly bought the British products and were disappointed. Therefore, Lever argued, the unauthorized sales of British products damaged its reputation and degraded its trademark in the United States, in violation of § 42 of the Lanham Act.

The defendant and the Customs Service argued that a trademark applied by an affiliate of the American trademark holder was not a “copy” or a “simulation,” and was automatically “genuine” under § 42, regardless of whether the goods were identical to those sold in the United States. 91 The

88 Id.
89 Note also that the common control exception would not apply where the goods are “materially different” from the U.S. trademarked good, and § 1526 therefore would operate to exclude the goods in most such cases anyway. Thus, the Lanham Act simply provides another alternative cause of action for U.S. trademark holders in such situations.
90 981 F.2d 1330 (D.C. Cir. 1993).
91 Id. at 1337.
highly influential District of Columbia Circuit Court of Appeals disagreed, finding that § 42 was aimed at “deceit and consumer confusion...[w]hen identical trademarks have acquired different meanings in different countries, one who imports the foreign version to sell it under that trademark will... cause the confusion Congress sought to avoid. The fact of affiliation between the producers in no way reduces the probability of that confusion.”\(^92\) Neither § 42 nor its legislative history and administrative record demonstrate any intent to apply a “common control” or “affiliate” exception to the proscriptions of § 42; therefore, said the Court, the imported U.K. products, being “materially different” than those sold in the United States, were not “genuine” and could not be imported without Lever Bros. U.S.’s consent.\(^93\)

Similarly, in Martin’s Herend Imports, Inc. v. Diamond & Gem Trading USA Co.,\(^94\) Martin’s, an American corporation, was the exclusive U.S. distributor for Herendi Pocelanyar, the Hungarian manufacturer of Herend porcelain, and was solely authorized to use Herendi’s U.S. trademark in the United States. Martin’s chose only certain Herendi pieces to sell in the United States, while other pieces were sold all over the world pursuant to Herendi’s other distributorships. The defendant purchased genuine, first-quality Herend pieces (including pieces not sold by Martin’s in the U.S.) from retailers in the United States and abroad, all with valid trademarks, and resold them in competition with Martin’s. Applying § 32 of the Lanham Act, the Fifth Circuit Court of Appeals prohibited the importation, finding that the goods were materially different from those sold by Herendi’s sole authorized distributor in the United States. Even though the defendant’s pieces were of the same high quality as those sold by Martin’s, the court found that when the goods are rare, highly artistic, luxury goods, such as Herend porcelain, the trademark holder had the right to strictly limit who sells its goods because “maintaining the goodwill of its trademark may depend on the stores where the goods are sold, advertising, the selection of which of the thousands of Herendi pieces will be offered for sale in this country, and many other factors.”\(^95\)

\(^92\) Id. at 1338.
\(^93\) Id. at 1331, 1337-38. However, the Court agreed that 19 C.F.R § 133.21, the common control exception to the Tariff Act, did apply to allow imports of goods originally sold overseas by affiliates of the U.S. trademark holder where those goods are identical to those sold in the United States. Id. at 1331.
\(^94\) 112 F.3d 1296 (5th Cir. 1997).
\(^95\) Id. at 1302-03. The Court based its § 32 decision on “customer confusion” that may arise from allowing an unapproved dealer such as the defendant to have the “first sale” of the goods in the United States, despite the fact that “customer confusion” is not mentioned at all in § 32, but rather in § 43 of the Lanham Act (see infra note 99 and accompanying text).
Likewise, in *Societe des Produits Nestlé, S.A. v. Casa Helvetia, Inc.*, Nestlé, a French company, owned the U.S. and foreign trademarks for Perugina chocolates, which were made in Italy and sold in Puerto Rico through a Nestlé affiliate. In Venezuela, Nestlé sold less expensive Perugina chocolates that it claimed were inferior in "presentation, variety, composition, and price" to those sold in Puerto Rico. The defendant (Nestlé’s former Puerto Rican distributor) bought the Venezuelan chocolates and imported them to Puerto Rico for sale under the Perugina name at a cheaper price than the better Perugina chocolates sold there by the Nestlé affiliate. Nestlé argued that these imports and sales of “materially different ... chocolates threatened to erode ‘the integrity of the Perugina trademarks as symbols of consistent quality and goodwill in Puerto Rico.’” The court held that if indeed the Venezuelan chocolates were inferior, they were “not genuine” for purposes of U.S. law and consumer confusion and degradation of the Nestlé distributor’s goodwill could be presumed, therefore violating both § 32 and § 42 of the Lanham Act.

Section 43 of the Lanham Act (15 U.S.C. §1125) can also be used to bar the third party sale of trademarked goods in the United States which are different from those sold by the American trademark owner. Section 43 prohibits the “use in commerce [of] any word, term, name, symbol, or device ... which (1) 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.” Under § 43,
the U.S. trademark owner would assert that the differences between the products, even if not harmful or significant, may cause confusion or trick American consumers into thinking that the foreign product is sponsored or endorsed by the U.S. trademark owner, thereby eroding its trademark. For example, in *Fender Musical Instruments Corp. v. Unlimited Music Center Inc.*, the trademark owner of "Fender" guitars sold its products in the United States only through authorized dealers. Fender also sold guitars in Japan, but they were materially different than those made and sold in the United States—for example, they had only Japanese language manuals, and had different neck shapes, replacement parts, available colors, and warranties. The defendant music store was not an authorized Fender dealer, but purchased Fender guitars in Japan and imported them to the United States, where it advertised and sold them with the Japanese Fender trademark on them at prices much lower than Fender dealers sold the American Fender guitars. Citing § 43's prohibition on making representations that are "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," the court stated that unauthorized sale of trademarked goods alone was not sufficient to violate this section; there must also be use of the trademark "in a manner likely to cause the public to believe that the defendant is a participant in the trademark holder's authorized sales network." In this case, the court took note of the high reputation of Fender guitars, and the expectation of customers that anyone selling Fender guitars is an approved and authorized dealer with "a certain respectability. Because new Fender guitars are unique and highly regarded, an unauthorized seller of 'new' Fender guitars would deceive the customer into believing that the dealer met the qualifications of an authorized dealer." In finding that the defendant had violated § 43, the court did not require Fender to show that actual customer confusion existed, only the likelihood of confusion.

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101 Id. at 3.
102 Id.
103 Id. The court also found a violation of § 32 of the Lanham Act's prohibition on sales of trademarked goods due to the likelihood of confusion, mistake or deception of the buyers of the defendant’s products. Some American courts, however, do not allow the use of § 43 against the importation of genuine goods, even if they are different from those sold by the U.S. trademark owner in the U.S. See, e.g., Olympus Corp. v. U.S., 792 F.2d 315, 321 (2d Cir. 1986) ("The plain language of § 43 does not bar importation if the goods are genuine, only if they ‘copy or simulate’ a trademark"). However, most of those courts accept the use of §§ 32 and 42 to prohibit importation of genuine but materially different goods.
C. Summary of U.S. Law on Gray Market Goods

In summary, U.S. law on gray market goods consists of two sets of statutes: § 1526 and its regulations, including the common control exception, and §§ 32, 42, and 43 of the Lanham Act. The first operates to exclude imported goods which have identical trademarks to U.S. goods and are not materially different from those U.S. goods, unless the imported goods were sold abroad by a close affiliate of the U.S. trademark owner, in which case the U.S. trademark holder’s rights are exhausted and imports are allowed into the United States for sale. The Lanham Act statutes operate to exclude imported goods from the United States where they have trademarks identical to those of U.S. goods but the products themselves are different from their counterparts in the United States. Therefore, they can be viewed as “not genuine.” While all jurisdictions agree on the operation of § 1526 and the common control exception, there is some disagreement between the federal circuits about the application of the Lanham Act sections.

D. Contractual Attempts to Prevent Gray Market Imports

Trademark owners in the United States are not helpless to prevent competing gray market sales of products identical to those they sell in the United States. Indeed, through careful drafting of their sales contracts, using vertical restraints on their distribution systems, U.S. trademark holders can prohibit sales outside the United States, sales of multiple items, or sales to particular buyers.

U.S. antitrust law generally approves of vertical restraints that do not involve pricing, such as “territorial exclusivity,” that is, a manufacturer’s decision to sell only to authorized distributors and to limit them to selling in particular territories. The U.S. Supreme Court, in Continental T.V., Inc. v. GTE Sylvania Inc., held that when a single manufacturer not in collusion with competitors opts to impose vertical restraints on its distributors and sellers, “the restraint is nearly always efficient, output increasing, and good for consumers, and ... government restraints (antitrust rules) against the freedom of firms to choose how to distribute their own product are nearly always inefficient, output decreasing, and harmful to consumers.”

The interaction of this antitrust policy with gray market policy is exemplified in International Logistics Group, Ltd. v. Chrysler Corp., wherein Chrysler had sold Power Master engines to U.S. distributors exclusively for export outside the United States. Because the engines’ prices were significantly below the domestic price of Chrysler engines, Chrysler

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106 884 F.2d 904 (6th Cir. 1989).
prohibited the distributors from reselling the engines inside the United States. Defendant purchased the engines under the pretext of exporting them but instead sold them to its affiliate, which resold them in the United States in competition with Chrysler. When Chrysler cut off defendant’s supply, he alleged antitrust violations. The Sixth Circuit Court of Appeals, however, approved Chrysler’s behavior, saying that such vertical restraints placed on distributor-purchasers of the Power Master engines were acceptable because they were unilaterally made (i.e., not in concert or conspiracy with Chrysler competitors) and were merely Chrysler’s “formulations of marketing conditions” for its product which were not harmful to competition.107

American businesses have the ability to pick and choose to whom they sell, and they may unilaterally refuse to deal with certain buyers. In *Westman Commission Co. v. Hobart Int’l, Inc.*,108 the Tenth Circuit Court of Appeals noted that barring monopolistic market power and collusion with competitors, a manufacturer has “wide latitude” to decide to whom he sold, based on what he thought would be the most beneficial to his business.109 In that case, Hobart, a high-end restaurant kitchen equipment manufacturer, refused to grant a distributorship to defendant Westman because its leading distributor in the same market, Nobel, threatened to end its distributorship if Hobart granted Westman a distributorship. Westman alleged that Hobart and Nobel had conspired in a refusal to deal with Westman, in violation of §1 of the Sherman Antitrust Act. Noting that “the purpose of the antitrust laws is the promotion of consumer welfare,” and that “antitrust laws should not restrict the autonomy of independent businessmen when their activities have no adverse impact on the price, quality, and quantity of goods and services offered to the consumer,” the Tenth Circuit Court of Appeals held that manufacturers had the right to choose those they sold to and those they did not.110

Thus, U.S. trademark holders can insert into contracts with their distributors prohibitions on (a) reselling their products in the United States, or (b) exporting items to other countries, in an attempt to prevent their products from competing with them in the United States or “escaping” to other countries where they might be sold as gray market imports in competition

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107 *Id.* at 907.
108 796 F.2d 1216 (10th Cir. 1986).
109 *Id.* at 1220; see also *Seagood Trading Corp. v. Jerrico Inc.*, 924 F.2d 1555, 1567 (11th Cir. 1991) (“It is well established that a party ‘may choose with whom he will do business and with whom he will not do business,’ and that this behavior, referred to as ‘exclusive dealing,’ will not give rise to liability absent a showing of actual competitive injury,” quoting *Construc. Aggregate Transp., Inc. v. Fla. RockIndus., Inc.*, 710 F.2d 752, 772-73 (11th Cir. 1983)).
110 Westman, 796 F.2d at 1220.
with the U.S. company’s overseas affiliate. Another alternative is prohibiting distributors from selling more than one (or a few) of the products to a single buyer, making a gray marketer’s efforts to amass products much more difficult.  

In contrast, competition law in the European Union prohibits such contractual provisions, and greatly decreases the ability of E.U. trademark owners to prevent buyers from re-selling their trademarked products within the E.U. member states. Indeed, while the focus of American antitrust law is the effect on consumers, not competitors, the focus of E.U. competition law is exactly the opposite. Article 81(1) of the Treaty Establishing the European Community prohibits “as incompatible with the common market: all agreements … which may affect trade between Member States and which have as their object or effect the prevention, restriction or distortion of competition within the common market.” Thus, any efforts by an E.U. trademark holder to restrict its distributors from re-selling its products in other E.U. countries will likely violate Article 81(1) and be void. Although collusion of two or more parties is required to find a violation of Article 81(1), it is far more easily found in Europe than in the United States—it is fairly well-established in E.U. courts that contractual measures adopted unilaterally by a manufacturer to restrain its dealers or distributors can be “collusion” if the dealers/distributors tacitly acquiesce to the terms.  

However, when a trademark owner sells to retail stores, contractual restraints on further sales become far more difficult and ineffective because these buyers usually sell to the public at large, without asking the purchaser’s identity or intent in buying the product. To use a relevant example, say that Widget Corporation of America agrees to sell one million widgets to ABC Department Store of Canada, and includes in its sales contract prohibitions on ABC exporting the widgets back to the United States, selling the widgets to any purchaser who intends to export them, or selling more than 100 widgets to a single purchaser. Even if ABC is diligent in following this provision of the contract, it cannot possibly investigate every purchaser to ensure that he/she is not exporting the widgets, returning to the store every day to purchase 100 more, or having several individuals purchase for it 100 widgets each in order to export them in bulk. Nor can ABC be realistically expected to require all buyers of the widgets in Canada to sign a sales contract promising not to do so. Thus, while contracts are a theoretically viable means in the United States to decrease gray marketers’ opportunities to purchase trademarked goods, in practice, they are far from foolproof.  

See Korah, supra note 48, at 981. Professor Korah has criticized the European Union’s prohibition on trademark holders’ use of territorial restraints to prevent parallel imports because they fail to recognize that price discrimination and territorial segmentation can lead to increased output and more sales, rather than restraining trade.  

See also Korah, supra note 48, at 975–76.
ten prohibitions against sales in other E.U. countries, physically placed on the trademarked products themselves (as Tesco argued unsuccessfully that Levi Strauss had to do so in order to protect its trademark), would probably still violate Article 81(1) because buyers such as distributors and franchisees would "tacitly agree" to such an export ban when purchasing the items.\textsuperscript{116}

In summary, because U.S. antitrust law allows vertical, non-price-related restraints, U.S. trademark holders may use contractual restrictions to try to control the distribution and sale of their products, though such efforts by no means prevent the export of those products to other countries (or import of the products back into the United States). E.U. trademark holders, however, may not use even this marginally effective means to keep their products inside the country (or region) of first sale. Instead, they must turn to differentiate products from different countries by varying packaging and ingredients and erecting other non-contractual obstacles to parallel imports.

V. COMPARING U.S. AND E.U. LAWS ON GRAY MARKET GOODS

The European Union follows a strict policy of "regional exhaustion" while the United States follows a policy that was intended to be national but is in practice almost international. Operationally, U.S. and E.U. laws on gray market goods are similar where the goods being imported are identical to goods sold domestically and were originally sold by an entity unrelated to the domestic trademark holder – in both the United States and the European Union, such goods will be not be allowed into the country. Similarly, both the United States and European Union will exclude imported counterfeit goods with trademarks identical to goods sold domestically. Where the U.S. and E.U. laws differ—and it is, in practice, a very important differ-

\textsuperscript{116} For a short review of other countries' laws on contractual restrictions on exports, see AIPPI Report, \textit{supra} note 41, at 3-4.
ence—is when the imported goods were originally sold in another country by the domestic trademark holder itself or an entity that is related to it. In such a case, the import will be allowed into the United States under the common control exception. But in the European Union, the product will be excluded from importation because the related entity is defined as separate from the domestic trademark holder, so no trademark exhaustion has taken place yet.

_Levi Strauss v. Tesco_ is an example of this important disparity in exhaustion systems. E.U. law prevented the importation into the United Kingdom of the gray market Levis jeans from North America despite the fact that a company directly related to Levi Strauss U.K. had sold them there. In the United States, under similar circumstances, the common control exception would have applied to allow the U.K. Levis into the United States, and they would likely have ended up on store shelves across America at prices lower than U.S. domestic prices, thus benefiting U.S. consumers (but also causing the potential problems identified in Section III).

Another difference between U.S. and E.U. law is that in the European Union, under _Sebago,_ a trademark holder cannot be deemed to have consented to the sale in the European Union of a particular batch of products by having consented to the sale in the European Union of other batches of identical goods. In the United States, consent is deemed present in such a case; that is, where a U.S. trademark holder consents to the sale in the United States of a certain kind of product, batches of identical products, although sold first outside of the United States, may be imported and sold in the United States.

VI. SHOULD THE EUROPEAN UNION CHANGE ITS LAW ON GRAY MARKET GOODS?

Given the pro’s and con’s of international exhaustion, as explained in Section III, and having examined the United States’ quasi-international exhaustion system in comparison, we now turn to whether the European Union should heed the post- _Levi Strauss_ consumer advocates and adopt international exhaustion. There are several factors to consider in making this decision.

A. The Effect of International Exhaustion on Consumer Prices in the Long Term is Highly Debatable

The most frequently heard argument for the European Union to switch to international exhaustion is that it would cause E.U. consumer prices to

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118 _Id._ ¶ 22.
fall. However, this premise is far from proven—indeed, the evidence is decidedly ambiguous regarding whether consumers benefit in the long run from an international exhaustion system.

The most thorough study done to date regarding the economic effects on the European Union of regional vs. international exhaustion is the NERA Report commissioned by the European Commission,\(^\text{119}\) which draws no conclusions regarding which exhaustion regime is best but gathered data on the varying impacts of regional vs. international exhaustion on ten market sectors (comprised mostly of consumer goods) chosen for their relative importance in relation to trademarks and international trade.\(^\text{120}\) The NERA researchers interviewed 160 interested parties and organizations (such as trademark owners, import/export associations, and consumer advocacy organizations) in the European Union, the United States, and Japan; examined position papers and submissions by 33 other interested parties (such as retailers and associations of trademark owners and parallel traders); and studied statistical information, pricing data, and information on employment, profitability, output, and trade practices in different countries.

In the ten examined sectors, the NERA found that the United States generally has the lowest prices, Japan the highest, with the European Union in between.\(^\text{121}\) Taxes additional to the base prices were around 3% in Japan (in the form of VAT), 4-8% in the United States (in the form of state sales tax) and 18% in the European Union (in the form of VAT, sales and excise taxes). The NERA Report predicted that a unilateral E.U. change to international exhaustion or to a bilateral exhaustion regime with the United States and Japan\(^\text{122}\) would have the following immediate effects:

\(^\text{119}\) See NERA Report, supra note 57.

\(^\text{120}\) See id. at 1-2. The chosen sectors were: confectionery; alcoholic beverages; soft drinks and mineral water; clothing; footwear and other leather goods; musical recordings; cosmetics and perfumes; domestic appliances; consumer electronics; and automobiles.

\(^\text{121}\) But see id. at 35 (exceptions to this general finding were that wine, beer, and other alcoholic beverages, washing machines, and toiletries were cheaper in the European Union than in the United States, and cars, tires/car parts, consumer electronics, men’s clothing and children’s footwear were cheaper in Japan than in the European Union). Interestingly, Japan, with the highest prices, is the only country of the three to follow international exhaustion.

\(^\text{122}\) Such a bilateral regime would come about through treaties signed between the European Union and the United States, and/or between the European Union and Japan, that would effectively expand E.U. regional exhaustion to include the other country, and effect a corresponding change on the other country’s exhaustion system (although Japan already follows international exhaustion). However, such a bilateral treaty may fall under the scope of the TRIPs Agreement’s “Most Favoured National Treatment” clause (Article 4), which requires that “with regard to the protection of intellectual property, any advantage, favour, privilege, or immunity granted by a Member to the nationals of any other country shall be accorded immediately and unconditionally to the nationals of all other Members.” TRIPs Agreement, supra note 4, art. 4.
(1) An increase in gray market goods in the European Union;

(2) A reduction in average prices due to increased intra-brand competition from gray market imports, but a concomitant decrease in after-sales service and warranties;

(3) Lower prices might lead to increased sales and to the extent that gray market imports are produced abroad and imported into the European Union, such increased sales would accrue to the foreign sellers. If gray market imports replace local production, manufacturing employment in the European Union may fall. However, opening new distribution channels or retail outlets in the European Union may increase employment in that sector (which may or may not be offset by job reduction by trademark holders who lose profits due to gray market sales);

(4) A possibility of increased brand alternatives not available before in the European Union;

(5) Increased sales for unofficial wholesalers and retailers at the expense of authorized wholesalers and retailers;

(6) Less consistency in content, taste, and other characteristics of a trademarked product, and resulting consumer dissatisfaction harming the trademark holder; and

(7) An increase in counterfeit goods slipping through customs unless more resources are dedicated to stopping them.\(^{123}\)

In the longer term, however, the NERA Report concluded that a unilateral E.U. change to international exhaustion (or to a bilateral exhaustion regime with the United States and Japan) would have the following effects:

(1) Over a period of years, the fact that the European Union is a large market will "dampen the potential for major price reductions on individual products." Thus, the short-term price decreases likely brought about by international exhaustion in the European Union would disappear in a few years.

(2) Lower profits for trademark owners would inhibit investment in new brands (or even the retirement of certain brands altogether), advertising, distribution systems, and new markets, in order to make up for lost profits;

(3) For consumers, sub-section two would lead to reduced quality and variety in trademarked products and less after-sales services and warranties when trademark owners and their authorized sellers refuse to honor guarantees on goods identified as gray market imports;

\(^{123}\) NERA Report, supra note 57, at 36-40.
Trademark owners may withdraw from low-price markets to prevent gray market imports from that market, or increase their prices there to offset the potential harm in higher-price markets from gray market imports from the low-price market;

Trademark owners may greatly differentiate packaging from market to market to make goods less attractive in other markets;

Trademark holders may set up more selective distribution systems and prohibit sales to unauthorized dealers/parties (to the full extent such contractual terms are allowed in the European Union from country to country) and more rigorous enforcement of distributors' conditions on resale;

Cuts in R&D and other product improvement means (although not so drastic as to weaken the brand and the mark owner's own market position).

Thus, the NERA Report concluded that the short-term price cuts caused by gray market imports under an international exhaustion system in the European Union would soon evaporate, and the lasting effects of international exhaustion could be, on the whole, negative. However, the NERA Report looked at only ten types of consumer products, and the opinions it received from manufacturers regarding what they "would" do under an international exhaustion regime cannot necessarily be taken as wholly accurate predictors of their actual behavior if such a change occurred. While NERA certainly provided interesting information for the international vs. regional exhaustion debate, its lack of economic analysis and its narrow scope of inquiry render it of limited usefulness in accurately forecasting the results of an E.U. change to international exhaustion.

In December 1999, after receiving the NERA Report and holding two hearings (one with the member states and one with other interested parties), the European Commission submitted to the European Parliament and European Council a Working Paper regarding the possible expansion of the European Union's current regional exhaustion regime to one of international exhaustion through an amendment to the Trade Mark Directive as well as the Community Trade Mark Regulation. On May 25, 2000, the European Commission announced its decision to maintain the regional exhaustion regime "for the time being" because it had concluded, based on the NERA study and the

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124 Id. at 40-42, 109.

125 European Commission Staff Working Paper, Exhaustion of Trade Mark Rights - Working Document from the Commission Services (Dec. 9, 1999) [hereinafter 1999 Commission Working Paper]; see also Zarpellon, supra note 42, at 384. Four member states strongly supported the Commission approach, eight member states opposed it, and the remaining member states did not express a position. Id. at 386.
Commission’s member state and industry consultations, that a switch to international exhaustion would not cause significant decreases in E.U. consumer prices. The Commission emphasized that adopting international exhaustion while E.U. trading partners follow more protectionist regimes would disadvantage E.U. companies, making them vulnerable in the European Union to sales of their own goods at lower prices than they sell them in the European Union but rendering them unable to recoup these losses in other countries that do not practice international exhaustion. Further, the Commission pointed out that increased “e-commerce” is providing opportunities for E.U. consumers to access products from all over the world at lower prices even without a change in exhaustion regime, thus pressuring brand owners to decrease their prices to compete. Even with no change to the E.U.’s regional exhaustion system, such pressure on prices will only increase with the future enlargement of the European Union to Poland, the Baltic states, and other central and eastern European countries with lower standards of living (and lower prices) than in western Europe.

Several other studies regarding the potential effects of international exhaustion on individual member states of the European Union have taken place in the last few years. Immediately following the Silhouette ruling in July 1998, the Swedish Competition Authority commissioned two consultants to report on the economic advantages and disadvantages of parallel imports and specifically, their effects on Sweden. The resulting Swedish Competition Authority Report (hereinafter, “the Report”) concluded that under Sweden’s pre-Silhouette practice of international exhaustion, about 61% of Sweden’s parallel imports came from countries outside the EEA zone, and 39% came from other EEA members. Because a change to regional exhaustion (as required by the Silhouette ruling) obviously would affect only the imports from outside the EEA, the Report focused on the ill effects of the loss of roughly SEK 5.5 billion in non-EEA parallel imports. The Report concluded that in the short run, there would be a 0.2% general

126 Id. at 384.
127 See NERA Report, supra note 57, at 8, 86, 88, 90, 99 (estimating that for some sectors, the loss of profits under a unilateral E.U. change to international exhaustion would be double those under a multilateral or bilateral change).
128 Id.
129 See Silhouette, supra note 21, and accompanying text.
130 See Konkurrensverket Swedish Competition Authority, Parallel Imports – Effects of the Silhouette Ruling, 1999:1 Rept. Series at 133 (1999) [hereinafter Swedish Competition Report]. It is noteworthy that the Report admits that good statistical data was unavailable outside of the motor vehicles and pharmaceutical sectors, and that the volume and origins of parallel imports had to be estimated outside those two sectors. Id. at 91-94. The largest numbers of parallel imports were in the automobile spare part and clothing sectors. Id. at 133. The sectors examined by the Swedish Competition Report overlapped only slightly with those studied by the NERA Report.
price increase for consumers in the affected sectors, concomitant domestic job losses and loss of VAT, income tax, company tax and employer’s contributions to taxes. It also concluded (though without much evidence for such an estimate) that about half of the lost sales would shift to the internet and the other half would go to traditional retail and wholesale sellers. The Report did not estimate the gains that Swedish trademark holders would make or the number of jobs gained in Sweden from increased internet sales. In summary, the Swedish Report concluded that in Sweden, parallel imports had led to lower prices and increased consumer benefits, and that because Sweden was a high-price country, the mandatory switch to regional exhaustion after the Silhouette ruling would be to its citizens’ detriment, at least in the short term.

The effects of a switch to international exhaustion on the United Kingdom were studied by the United Kingdom House of Commons Select Committee on Trade and Industry, which heard evidence and testimony regarding parallel imports that led to a published report. The Committee’s Report concluded that for some goods, the potential consumer benefits of international exhaustion would outweigh the detriments, but that the reverse would be true in other sectors like music and pharmaceuticals. The Report recommended that the U.K. government lobby the European Union to adopt an international exhaustion regime with special protections to sectors where the regime change would have “severe detrimental effects.”

A 2001 French study examined the empirical work of NERA and the Economist Intelligence Unit (“EIU”), comparing average retail prices of eight categories of consumer goods in France, Germany, Sweden, the United Kingdom and the United States. This study found that of the 98

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131 Id. at 119. The largest increase in price was estimated to be in automobile spare parts (4-5%) and clothing (3%). Id. at 62.
132 Id. at 47-54, 58-60.
133 Id. at 61-65. The Swedish Competition Report did not consider effects on Swedish manufacturers and trademark holders but rather concentrated on gray marketeers, consumers and government. During the OECD Joint Group discussion on parallel imports on May 30, 2002, the Swedish delegation noted that after Sweden switched to regional exhaustion, parallel imports from both inside and outside the EEA declined, “...reinforc[ing] the conclusion that a change from global to regional exhaustion has reduced the parallel trade we would very much like to see as a part of the competitive element of the European internal market.” 2002 OECD Report, supra note 48, at 30.
134 See U.K. Trade and Industry Report, supra note 44.
135 Id. at ¶ 90.
products studied in the United States and the four E.U. countries, only 14 were cheaper in the United States, despite its more liberal exhaustion regime. Further, like NERA, the French report concluded that

...[P]rices within the [European Union] vary enormously across member states, despite the application of Community-wide [regional] exhaustion. Thus, France, which has never practiced international exhaustion, has the lowest prices of the four chosen [E.U.] members for 57 of the 133 products studied, while the United Kingdom, Sweden and Germany, which have had international exhaustion in the past, are the lowest priced countries for respectively, 9, 18, and 49 of the 133 products studied.138

This finding contradicts the arguments of the pro-international exhaustion advocates, who assert that international exhaustion automatically and irrevocably leads to lower prices than in countries with more restrictive exhaustion regimes.

The most recent study was undertaken by the Organization for Economic Co-operation and Development (“OECD”) Directorate for Financial, Fiscal, and Enterprise Affairs and Trade Directorate, released on June 26, 2002.139 This report synthesized the NERA Report, the Swedish Competition Report, prior OECD reports, the 2001 French study, a 1985 U.S. Department of Commerce report, including later studies done on that data, and 1998 reports from Australia and New Zealand. Although it reached no ultimate conclusion on whether regional or international exhaustion is best for the European Union, it did observe that

[the less vigorous is competition among [trademark] holders and among those distributing pertinent goods, and the more bans on parallel imports reduce such competition, the higher is the probability that bans on parallel imports reduce rather than increase economic welfare. ... Bans on parallel imports are likely to facilitate price discrimination, and simultaneously hinder free-riding. Price discrimination is more likely to improve welfare the greater the differences in market characteristics across the nations covered, and the more vigorous is competition at the [trademark] holder and authorized licensee levels. Free-riding can be presumed to harm welfare if competition is sufficiently strong in all markets, but its effects grow more and more ambiguous as competition weakens. 140

138 See OECD Report 2002, supra note 48, at 23. The French study only gathered data on pricing, and reached no conclusions regarding the advisability of changing to an international exhaustion regime.

139 Id.

140 Id. at 38 (emphasis in original). This can be easily seen by considering that some EEA countries, such as Sweden, tend to have high prices and low inflation and unemployment, whereas some EEA countries, such as Portugal and Greece (not to mention the countries expected to accede in 2004 such as Poland, Slovakia, and Hungary), tend to have low prices and higher inflation and unemployment.
In other words, this study concluded that in countries where there is little competition among producers of similar products, and fewer substitutes exist for a product, bans on parallel imports lead to price discrimination and cause higher prices. This makes intrinsic sense from an economic perspective. However, on an international scale, allowing manufacturers to price discriminate across countries with very different markets creates greater intra-brand competition (that is, competition between the manufacturer's own licensed dealers). Thus, the 2002 OECD Report reiterated other reports' findings that the effects of a change to international exhaustion by the European Union would have differing effects on different countries.\textsuperscript{141}

In summary, studies of the effects of parallel imports and the relative advantages of regional vs. international exhaustion generally have concluded that the results across the European Union are mixed—each system would have advantages and disadvantages for different countries. Most studies find that international exhaustion would bring short-term gains for consumers (an increase in available products and slightly lower prices) that would fade in the long-term, and short-term losses for producers/trademark holders that would also fade in the long term.

The upshot of these studies, then (though no study has drawn this conclusion overtly), is that the long-term effect of international exhaustion would be the same prices as before, but more product options for consumers and slightly more intra-brand competition for trademark holders, who would try to "even out" their prices across the European Union to decrease the incentives for parallel importers.

B. Probable U.S. Opposition to E.U. International Exhaustion

If the European Union re-examines the adoption of an international exhaustion system, the United States (the E.U.'s largest trading partner) is highly likely to object because American manufacturers (such as Levi Strauss U.S.) will lose the protection they presently enjoy under the E.U.'s regional exhaustion system. At present, goods which are less expensive in the United States cannot be sold in the European Union unless and until the U.S. manufacturer sells them there itself, even if an affiliate of the U.S. manufacturer is selling the goods in the European Union (as seen in \textit{Levi Strauss v. Tesco}). However, E.U. manufacturers are only protected from gray market imports in the United States if the E.U. manufacturer is not under "common control" with a U.S. company.\textsuperscript{142} If the European Union changed to an international exhaustion system, many U.S. companies would

\textsuperscript{141} \textit{Id.}
\textsuperscript{142} \textit{Id.}
suffer financially because parallel importers could purchase their products cheaper in the United States (or developing countries), export them to the European Union, and sell them in competition with the U.S. company and/or its E.U. affiliate (as Tesco tried to do with Levis).

E.U. consumers might answer, “So what? Why do we care what the United States thinks about our system, as long as it benefits our own E.U. consumers?” Such a response is very short-sighted given the repercussions on the U.S.—E.U. relationship that such a change most certainly would have. In response to the European Union considering a switch to international exhaustion, lobbyists from the largest American multinational corporations would exert enormous pressure on the current presidential administration—Republican, conservative, corporate-oriented, business-friendly, and highly patriotic and protectionist—to vigorously oppose such a move. If Corporate America is universally opposed to something, it is certain that the Bush administration (and Congress, for that matter) will react strongly. Second, in late July 2002, President Bush was given “fast-track” trade authority, which allows him and his trade representatives to conclude international trade agreements with assurance that Congress will vote “up or down” on them without amendments. This means that the corporate-friendly administration’s reaction to a hostile E.U. move will not have to be as measured and cautious as it would if moderating Congressional amendments were allowed. Third, it is possible that to offset the loss of profits the E.U. policy change would cause, U.S. corporations might raise prices in the United States and employ cost-cutting measures, which harm American workers; this would place American consumer advocacy and organized labor groups in the uncharacteristic position of joining Corporate America in its opposition to the European Union’s move.

With all of this opposition in the United States to an E.U. move to international exhaustion, the U.S. government would likely respond to such a move through countermeasures either in international trade (such as trade sanctions or protectionist moves such as subsidies to industries hurt by the European Union’s change) or in some other political arena. There are many forms such a reaction could take, and all would have severe ramifica-
tions not only on U.S.-E.U. relations, but on global trade and diplomacy as a whole.

C. Mixed Reactions From Other Developed Countries

The reaction of other developed countries to an E.U. move to international exhaustion is less clear—it depends on the relative economic and political weight of the corporations in those countries, as well as that country's own exhaustion system (those already using international exhaustion would likely welcome the European Union's adoption of it), available product options, and current pricing levels.

The stance of developing countries is also uncertain. When the exhaustion issue was raised during the Uruguay Round (1986-94), many developing countries supported a system of international rights exhaustion, hoping the removal of parallel import restrictions would expand export opportunities for their burgeoning companies. But, there is also a potentially significant downside for developing countries in that foreign trademark holders, to protect against profit losses caused by parallel imports from those countries to more expensive countries, might price their goods more uniformly across countries, causing increased prices in the developing nations or, in some cases, completely withdraw a product from the developing markets.

D. Increased Parallel Imports after 2004 Accession to European Union

By the end of 2004, it is likely that Poland, Hungary, the Czech Republic, Slovakia, Estonia, Cyprus, and perhaps other central/eastern European nations will accede to the European Union. The populace in these transition economies have personal incomes that are a fraction of those in today's European Union, and E.U. manufacturers will likely try to break into these markets (if they haven't already) by selling at prices lower than they do in the rest of the European Union. Thus, even with no change in the European Union's regional exhaustion system, goods available for sale in new E.U. member states will be available for parallel imports throughout the rest of the European Union. A change to international exhaustion prior to, or simultaneous with, the expansion of the European Union will compound greatly the already-serious effects on profits that will surely be felt by E.U. manufacturers and other trademark holders in that they would have to compete against gray marketers not only in the expanded European Union but in the rest of the world. For this reason alone, some E.U. manufacturers and trademark holders would vigorously oppose the European Union's adoption of international exhaustion, not to mention the other reasons detailed herein.
VII. ADOPTING A COMMON CONTROL EXCEPTION IN THE EUROPEAN UNION

In the wake of the *Levi Strauss v. Tesco* decision, consumers and industry in the European Union are at odds over whether the European Union should expand its system of trademark exhaustion. E.U. consumers are furious over the perception that their present system of regional, E.U.-wide exhaustion protects large multinational corporations and inflates prices in virtually every sector of consumer goods. Their anger is exacerbated by the fact that many of these goods are significantly cheaper in the United States (though perhaps not as many as they might think, according to the studies and accounting for the European Union's high VAT tax) even when the goods are not produced there. At the same time, however, E.U. manufacturers and trademark holders are bracing for an unavoidable increase in gray market goods in the European Union (and therefore increased intra-brand competition) when the Union expands eastward in 2004. Under such pressure, E.U. industry is highly opposed to changing the European Union's trademark exhaustion system to one of international scope.

Given the inherent advantages and disadvantages of the regional and international exhaustion systems, rather than debating which of these alternatives should be followed by the European Union, it is more useful to examine compromise approaches such as the United States' hybrid system, which offer advantages for both industry and consumers while avoiding some of the disadvantages of the purer forms of trademark exhaustion. Presently, the U.S. system and the E.U. system are similar in that they both allow gray market goods to be imported when the trademark holder has already sold the goods domestically and they are being re-sold domestically by a third party. Both the U.S. and the E.U. systems prohibit the import of gray market goods when the trademark holder has not sold those goods domestically. This policy protects domestic manufacturers and trademark licensees from competition within their own countries, thereby recognizing the trademark holder's investment in its brand name (such as research and marketing expenses) and preventing "free riders" on such investments in those countries.

However, the United States makes a huge exception to this latter policy—it will allow importation of gray market goods when those goods have been sold outside the United States by the U.S. trademark holder or a closely related entity because such an entity is, for all intents and purposes, identical to the U.S. trademark holder and at the very least shares a common commercial and financial purpose with the U.S. holder. If the first sale abroad was made by an unrelated or only distantly related corporation, the exception will not apply and the goods will be excluded from importation, since the trademark holder has not yet profited from the first sale of its product. Further, under the Lanham Act, goods will also be excluded if
they are materially different than the products sold in the United States by the domestic trademark holder or a related entity.

The result of the European Union adopting a similar common control exception would be that products sold both inside and outside the European Union (such as Levi Strauss jeans) could be sold as gray market imports in the European Union at prices lower than the manufacturer sells them. Thus, many goods imported from the United States, Southeast Asia, Mexico, and elsewhere would drop in price, as opportunistic importers purchase such goods at the cheaper prices abroad and resell them in the European Union. Off-price stores specializing in gray-market goods would soon spring up all over the European Union, driving down prices. Indeed, it is highly likely even consumer goods not sold abroad would drop in price in the European Union in order compete with the gray market goods.

While the U.S. manufacturers and trademark holders who sell their goods in Europe would object vociferously at such a change in E.U. policy, it is unlikely that the U.S. government or trade officials could take any action without extreme embarrassment since the European Union would be adopting the exact same policy the United States has had for eighty years. Further, an E.U. common control exception would have less detrimental effects on American industry than an across-the-board policy of international exhaustion, since American companies without related entities in the European Union would be unaffected by the former.

The European Union's adoption of a common control exception would benefit E.U. consumers while protecting trademark holders from unfair competition from gray market sellers. And, of course, its effect would be to unify the trademark exhaustion systems of the United States and the European Union, thus allowing the world's two largest consumer markets to cooperate in joint enforcement, regulations, and encouragement of other countries to adopt their system of trademark exhaustion.